

AT&T CORP. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS (Continued)

investment impairment charges of \$0.5 billion, primarily consisting of the impairment of Time Warner Telecom, and lower interest income of \$0.2 billion.

	<u>For the Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(Dollars in millions)		
Interest (expense)	\$(1,448)	\$(1,493)	\$(1,503)

Interest expense decreased \$45 million, or 3.0%, in 2002 compared with 2001, and decreased \$10 million, or 0.6%, in 2001 compared with 2000. The decrease in both periods was primarily due to lower average debt balances, reflecting our debt reduction efforts, partially offset by higher average interest rates. Average interest rates were higher in both periods due to the mix of short-term and long-term debt. The 2002 average rate was adversely affected by the \$10 billion bond offering in November 2001. We expect interest expense to be lower in future periods as a result of our debt reduction efforts.

	<u>For the Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(Dollars in millions)		
(Provision) for income taxes	\$(1,587)	\$(2,890)	\$(4,487)
Effective tax rate	56.0%	37.7%	35.9%

The *effective tax rate* is the *provision for income taxes* as a percent of income from continuing operations before income taxes. The 2002 rate was adversely impacted by approximately 14.9 percentage points due to the \$1.0 billion impairment charge recorded in 2002 relating to AT&T's interest in AT&T Latin America for which no tax benefit was recorded. Also negatively impacting the 2002 rate was the impact of AT&T Latin America's losses from operations for which no tax benefit was recorded because realization of a tax benefit was not likely to occur and the losses were not includable in AT&T's consolidated income tax return.

In 2001, the effective tax rate was positively impacted by tax benefits associated with the tax-free gain from the disposal of a portion of AT&T's retained interest in AT&T Wireless in a debt-for-equity exchange, partially offset by the consolidation of AT&T Latin America's pretax losses for which no tax benefit was provided.

In 2000, the effective tax rate was positively impacted by the tax benefits associated with certain legal entity restructurings and investments.

	<u>For the Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(Dollars in millions)		
Minority interest income	\$114	\$131	\$41

Minority interest income represents an adjustment to AT&T's income to reflect the less than 100% ownership of consolidated subsidiaries. Minority interest income decreased \$17 million in 2002 compared with 2001 as a result of lower net losses of AT&T Latin America in 2002. In December 2002, AT&T fully utilized the minority interest balance related to AT&T Latin America; therefore, we will no longer record minority interest income related to AT&T Latin America.

Minority interest income increased \$0.1 billion in 2001 compared with 2000 primarily due to AT&T Latin America, which we acquired on August 28, 2000; therefore, 2001 includes a full year of results, compared with a partial year in 2000.

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	<u>For the Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(Dollars in millions)		
Equity (losses) earnings from Liberty Media Group	\$—	\$(2,711)	\$1,488

Equity (losses) earnings from LMG, which are recorded net of income taxes, were a loss of \$2.7 billion in 2001, compared with earnings of \$1.5 billion in 2000. The decline of \$4.2 billion was largely driven by gains on dispositions recorded in 2000, including gains associated with the mergers of various companies that LMG had investments in, as well as higher stock compensation expense in 2001 compared with 2000. Partially offsetting these declines were lower impairment charges recorded on LMG's investments to reflect other than temporary declines in value. Equity losses for 2001 reflect results through July 31, 2001, the deemed effective date of the split-off.

	<u>For the Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(Dollars in millions)		
Net (losses) earnings related to other equity investments	\$(400)	\$(4,836)	\$10

Net (losses) related to other equity investments, which are recorded net of income taxes, declined \$4.4 billion in 2002 compared with 2001 due to lower net losses of \$2.1 billion for Concert, \$1.5 billion for AT&T Canada and \$0.8 billion for Net2Phone, primarily resulting from impairment charges recorded in 2001.

Net (losses) related to other equity investments, net of income taxes, were \$4.8 billion in 2001 compared with income of \$10 million in 2000. The unfavorable variance of \$4.8 billion was primarily due to greater losses of \$2.2 billion for Concert, \$1.8 billion for AT&T Canada and \$0.8 billion for Net2Phone primarily due to impairment charges recorded in 2001.

The after-tax amortization of excess basis associated with nonconsolidated investments, recorded as a reduction of income, totaled \$36 million in 2001, and \$37 million in 2000.

Effective January 1, 2002, in accordance with the provisions of SFAS No. 142, we no longer amortize excess basis related to nonconsolidated investments.

	<u>For the Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(Dollars in millions)		
Net (loss) from discontinued operations, net of income taxes ..	\$(14,513)	\$(4,052)	\$(4,863)
Gain on disposition of discontinued operations	1,324	13,503	—

Net (loss) from discontinued operations, net of income taxes, primarily represents the operating results of AT&T Broadband and AT&T Wireless, which AT&T disposed of and accounted for as discontinued operations. Accordingly, the revenue, costs and expenses of AT&T Broadband and AT&T Wireless have been excluded from the respective captions in the Consolidated Statements of Operations.

In 2002, the net (loss) from discontinued operations included a loss of \$14.5 billion from the discontinued operations of AT&T Broadband, and an estimated loss on the litigation settlement associated with the business of Lucent Technologies Inc., which was spun-off from AT&T in 1996 and accounted for as a discontinued operation. *Sparks, et al. v. AT&T and Lucent Technologies Inc. et al.*, was a class action lawsuit filed in 1996 in Illinois state court. On August 9, 2002, a settlement proposal was submitted to and accepted by the court. In accordance with the separation and distribution agreement between AT&T and Lucent Technologies Inc., AT&T recorded its proportionate share of the settlement and estimated legal costs, which totaled \$33 million, net of tax. Depending upon the number of claims submitted and accepted, the actual cost

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of the settlement to AT&T may be less than stated amounts, but it is not possible to estimate the amount at this time.

In 2002, we realized a noncash *gain on the disposition of AT&T Broadband* of \$1.3 billion, which represented the difference between the fair value of AT&T Broadband at the date of the spin-off and AT&T's book value, net of certain charges triggered by the spin-off of \$159 million, and the related income tax effect of \$61 million. These charges included compensation expense due to the accelerated vesting of stock options as well as the enhancement of certain incentive plans.

In 2001, the net (loss) from discontinued operations included a loss of \$4.2 billion from the discontinued operations of AT&T Broadband, and income of \$150 million from the discontinued operations of AT&T Wireless.

In 2001, we realized a tax-free noncash gain on the disposition of discontinued operations of \$13.5 billion, representing the difference between the fair value of the AT&T Wireless tracking stock at the date of the split-off and AT&T's book value.

In 2000, the net (loss) from discontinued operations consisted of a loss of \$5.4 billion from the discontinued operations of AT&T Broadband, and income of \$536 million from the discontinued operations of AT&T Wireless.

	For the Years Ended December 31,		
	2002	2001	2000
	(Dollars in millions)		
Cumulative effect of accounting changes	\$(856)	\$904	\$—

Effective January 1, 2002, we adopted SFAS No. 142, "Goodwill and Other Intangible Assets." In accordance with SFAS No. 142, franchise costs were tested for impairment as of January 1, 2002, by comparing the fair value to the carrying value (at the market level). As a result of this test, an impairment loss (related to discontinued operations) of \$0.9 billion, net of income taxes of \$0.5 billion, was recorded in 2002.

Effective January 1, 2001, we adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The cumulative effect of this accounting change, net of applicable income taxes, was comprised of \$0.4 billion for AT&T Group (of which \$0.2 billion related to discontinued operations) and \$0.5 billion for LMG. The \$0.4 billion recorded by AT&T Group was attributable primarily to fair value adjustments of equity derivative instruments embedded in indexed debt instruments and warrants held in public and private companies. The \$0.5 billion recorded by LMG represents the impact of separately recording the embedded call option obligations associated with LMG's senior exchangeable debentures.

	For the Years Ended December 31,		
	2002	2001	2000
	(Dollars in millions)		
Dividend requirements of preferred stock	\$—	\$(652)	\$—
Premium on exchange of AT&T Wireless tracking stock	—	(80)	—

Dividend requirements of preferred stock were \$0.7 billion in 2001. The preferred stock dividend represented interest in connection with convertible preferred stock issued to NTT DoCoMo in January of 2001 as well as accretion of the beneficial conversion feature associated with this preferred stock. The beneficial conversion feature was computed upon the issuance of the NTT DoCoMo preferred stock and represented the excess of the fair value of the preferred shares issued over the proceeds received. This beneficial feature was being accreted over the time period DoCoMo was required to hold the shares. On July 9, 2001, in conjunction with the split-off of AT&T Wireless Group, these preferred shares were converted into AT&T Wireless common stock. As a result, the beneficial conversion feature was fully accreted.

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In May 2001, AT&T completed an exchange offer of AT&T common stock for AT&T Wireless tracking stock. In 2001, this exchange resulted in a premium of \$80 million, which was a reduction of net income available to common shareowners. The premium represented the excess of the fair value of the AT&T Wireless tracking stock issued over the fair value of the AT&T common stock exchanged and was calculated based on the closing share prices of AT&T common stock and AT&T Wireless tracking stock on May 25, 2001.

Segment Results

AT&T's results are segmented according to the customers we service: AT&T Business Services and AT&T Consumer Services. The balance of AT&T's continuing operations (excluding LMG) is included in a "Corporate and Other" group. This group primarily reflects corporate staff functions and the elimination of transactions between segments. The discussion of segment results includes revenue, earnings before interest and taxes (EBIT), capital additions and total assets.

EBIT is the primary measure used by AT&T's chief operating decision makers to measure AT&T's operating results and to measure segment profitability and performance. AT&T calculates EBIT as operating income plus other (expense) income, net, pretax minority interest income and pretax net (losses) earnings related to other equity investments. Interest and income taxes are not factored into the segment profitability measure used by the chief operating decision makers; therefore, trends for these items are discussed on a consolidated basis. Management believes EBIT is meaningful to investors because it provides an analysis of operating results using the same measure used by AT&T's chief operating decision makers. EBIT for AT&T was \$3.9 billion, \$1.5 billion and \$14.0 billion for the years ended December 31, 2002, 2001 and 2000, respectively. We provide EBIT, a measure not calculated in accordance with generally accepted accounting principles (GAAP), for AT&T in order to provide investors a means to evaluate the financial results of each segment in relation to total AT&T. The table below provides a reconciliation of EBIT to operating income. Our calculations of EBIT may or may not be consistent with the calculation of this measure by other public companies. EBIT should not be viewed by investors as an alternative to a GAAP measure of performance, such as operating income.

	For the Years Ended December 31,		
	2002	2001	2000
	(Dollars in millions)		
EBIT	\$3,886	\$1,507	\$13,973
Deduct:			
Other (expense) income	(77)	1,327	1,190
Minority interest income	114	131	41
Pretax net (losses) related to other equity investments	(512)	(7,783)	(51)
Operating income	<u>\$4,361</u>	<u>\$7,832</u>	<u>\$12,793</u>

Total assets for each segment generally include all assets, except intercompany receivables. Prepaid pension assets and corporate-owned or leased real estate are generally held at the corporate level, and therefore are included in the Corporate and Other group. The total assets of discontinued operations and the related (loss) as well as the gain on disposition are not reflected in the Corporate and Other group. Capital additions for each segment include capital expenditures for property, plant and equipment, additions to nonconsolidated investments and additions to internal-use software.

Our existing segments reflect certain managerial changes that were implemented during 2002. The changes primarily include the following: revenue previously recorded by the AT&T Business Services segment

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as "Internal revenue" for services provided to certain other AT&T units and then eliminated within the Corporate and Other group is now recorded as a contra-expense by AT&T Business Services; the results of certain units previously included in the Corporate and Other group were transferred to the AT&T Business Services segment; the financial impacts of SFAS No. 133 that were previously recorded in the Corporate and Other group were transferred to the appropriate segments. In addition, AT&T Consumer Services and total AT&T revenue was restated in accordance with Emerging Issues Task Force (EITF) issue 01-9, "Accounting for Consideration Given by a Vendor to a Customer," which requires cash incentives given to customers previously recorded as advertising and promotion expense now to be recorded as a reduction of revenue when recognized in the income statement, unless an identifiable benefit is received in exchange. All prior periods have been restated to reflect these changes.

Reflecting the dynamics of our business, we continuously review our management model and structure, which may result in additional adjustments to our operating segments in the future.

AT&T Business Services

AT&T Business Services offers a variety of global communications services to small and medium-sized businesses, large domestic and multinational businesses and government agencies. Their services include long distance, international, toll-free and local voice; data and IP services; managed services; and wholesale transport services (sales of services to service resellers). Data and IP services are broad categories of services in which data (i.e. e-mail, video or computer files) is transported from one location to another. In packet services, data is divided into efficiently sized components and transported between packet switches until it reaches its final destination, where it is reassembled. Packet services includes IP, frame relay and Asynchronous Transfer Mode or "ATM." Managed services delivers end-to-end enterprise networking solutions by managing networks, servers and applications.

	For the Years Ended December 31,		
	2002	2001	2000
	(Dollars in millions)		
External revenue			
Services revenue	\$25,856	\$26,947	\$27,900
Equipment and product sales	379	317	236
Total external revenue	26,235	27,264	28,136
Internal revenue	323	441	423
Total revenue	<u>\$26,558</u>	<u>\$27,705</u>	<u>\$28,559</u>
EBIT	\$ 1,638	\$(2,305)	\$ 5,917
Capital additions	3,716	5,451	6,841
	At December 31,		
	2002	2001	
	(Dollars in millions)		
Total assets	\$36,365	\$40,316	

Revenue

AT&T Business Services revenue decreased \$1.1 billion, or 4.1%, in 2002 compared with 2001, and decreased \$0.9 billion, or 3.0% in 2001 compared with 2000. The declines were primarily driven by a decline in

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long distance voice revenue of \$1.7 billion in 2002 and \$2.0 billion in 2001. Partially offsetting the decline was growth in data/IP/managed services, including equipment sales, and local voice services of \$0.7 billion in 2002 and \$1.3 billion in 2001.

In 2003, we expect long distance voice revenue will continue to decline, reflecting continued competitive pressure as well as an accelerating shift in the retail/wholesale mix. We expect the declines in long distance voice revenue will continue to be partially offset by growth in local and data/IP/managed services.

Long distance voice revenue declined approximately 12% in 2002 compared with 2001, and approximately 13% in 2001 compared with 2000, reflecting the continued impact of pricing pressures and a change in the wholesale-retail product mix. While long distance volumes grew at a low single-digit rate in 2002 and 2001, the increase was driven by growth in lower-priced wholesale volumes that was essentially offset by a decrease in higher-priced retail volumes. These factors are expected to continue to negatively impact revenue in 2003.

Data/IP/managed services, excluding equipment and product sales, increased approximately 5% in 2002 compared with 2001. Growth was driven by increased sales in packet services, which grew at a rate of approximately 17%, partially offset by a decline in private line services (a service in which the connection is dedicated to the customer), reflecting an industry trend of customers migrating from private line services to more cost-effective and technologically-advanced packet services. When we include equipment and product sales, data/IP/managed services increased approximately 6%.

Data/IP/managed services increased approximately 13% in 2001 compared with 2000, with or without the impact of equipment sales. The growth was led by packet services, which grew at a mid-20 percent rate.

Local voice services revenue grew approximately 13% in 2002 compared with 2001 and more than 20% in 2001 compared with 2000. This growth reflects our continued focus on increasing the utilization of our existing footprint. AT&T added approximately 676,000 access lines in 2002. Access lines at the end of 2002 and 2001 were approximately 3.6 million and 2.9 million, respectively.

AT&T Business Services internal revenue decreased \$0.1 billion in 2002 compared with 2001 and was relatively flat in 2001 compared with 2000. The impact of internal revenue is included in the revenue by product discussions, above. The decrease in internal revenue in 2002 compared with 2001 was primarily due to the split-off of AT&T Wireless on July 9, 2001, as these sales are now reported as external revenue, partially offset by an increase in sales to AT&T Broadband. Sales to AT&T Broadband were recorded as internal revenue through the November 18, 2002, date of disposition. Subsequent to November 18, 2002, sales to AT&T Broadband, now Comcast, are recorded as external revenue.

EBIT

In 2002, EBIT increased \$3.9 billion, or 171.1%, compared with 2001. The improvement was primarily due to a decrease in pretax net losses related to equity investments of \$3.5 billion for Concert and \$2.6 billion for AT&T Canada driven primarily by impairment charges and equity losses recorded in 2001, as well as \$0.4 billion in lower restructuring charges recorded in 2002. This improvement was partially offset by a decrease in the long distance voice business resulting primarily from the impact of pricing pressures, a \$1.0 billion impairment charge recorded in 2002 for AT&T Latin America, and a gain of approximately \$0.5 billion recorded on the sale of our stake in Japan Telecom in 2001.

In 2001, EBIT decreased \$8.2 billion, or 138.9%, compared with 2000. The decline was primarily due to higher losses of \$3.5 billion related to Concert and \$3.0 billion related to AT&T Canada, primarily due to impairment charges recorded in 2001. Also reflected in the decline was the impact of long distance voice pricing pressure, as well as a shift from higher-margin long distance services to lower-margin growth services.

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Other Items

Capital additions decreased \$1.7 billion in 2002 compared with 2001 and \$1.4 billion in 2001 compared with 2000 as we continue to maintain a disciplined focus on capital spending. Although these declines reflect significantly lower capital expenditures for network assets that support all services provided by AT&T, we continue to focus the majority of our capital spending on our data, IP and local voice products.

Total assets decreased \$4.0 billion, or 9.8%, at December 31, 2002, compared with December 31, 2001. The decrease reflects lower receivables primarily driven by the settlement of receivables from Concert in connection with the Concert unwind, improved cash collections and lower revenue. The decrease also reflects the write-off of the assets associated with the impairment of AT&T Latin America.

AT&T Consumer Services

AT&T Consumer Services provides a variety of communications services to residential customers including domestic and international long distance; transaction-based long distance, such as operator-assisted service and prepaid phone cards; local and local toll (intrastate calls outside the immediate local area); and dial-up Internet.

	<u>For the Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	<u>(Dollars in millions)</u>		
Revenue	\$11,527	\$14,843	\$18,643
EBIT	2,647	4,875	6,893
Capital additions	127	140	148
	<u>At December 31,</u>		
	<u>2002</u>	<u>2001</u>	
	<u>(Dollars in millions)</u>		
Total assets	\$ 1,674	\$ 2,141	

Revenue

AT&T Consumer Services revenue declined \$3.3 billion, or 22.3%, in 2002 compared with 2001, and \$3.8 billion, or 20.4%, in 2001 compared with 2000. The decline in both periods was primarily due to long distance revenue, which fell \$3.6 billion in both 2002 and 2001. These declines were largely driven by traditional long distance voice services, such as domestic and international dial services (long distance calls where the number "1" is dialed before the call), and domestic calling card services. The traditional long distance voice services revenue was negatively impacted by substitution and the impact of ongoing competition, which has led to a loss of market share. In addition, the continued migration of customers to optional calling plans and lower-priced products, such as prepaid cards, has also negatively impacted revenue. The revenue decline for 2001 also reflects a \$0.5 billion impact due to the elimination of per-line charges in July 2000. Partially offsetting these declines was growth of \$0.2 billion in both 2002 and 2001 related to local services. Calling volumes declined at a low-teen percentage rate in 2002, and a low double-digit percentage rate in 2001 as a result of competition and wireless and Internet substitution, partially offset by an increase in prepaid card usage.

In 2002, approximately 5% of AT&T Consumer Services total revenue and more than 50% of prepaid card revenue was related to a contract with Wal-Mart, Inc. If this contract is not renewed at the next renewal date, January 31, 2004 (subject to early termination if certain events occur), AT&T Consumer Services revenue would be adversely affected if we are unsuccessful in selling the cards through a different channel. We

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expect product substitution, competition (including the continued entry of the Regional Bell Operating Companies (RBOCs) into the long distance market) and customer migration to lower-priced calling plans and products to continue to negatively impact AT&T Consumer Services revenue in 2003.

EBIT

EBIT declined \$2.2 billion, or 45.7%, in 2002 compared with 2001 and declined \$2.0 billion, or 29.3%, in 2001 compared with 2000. The declines in both periods were primarily due to the revenue declines in the long distance business. Also impacting the EBIT decline in 2002 was an asset impairment charge of \$0.2 billion recorded in 2002 related to the Digital Subscriber Line (DSL) assets that will no longer be utilized by AT&T as a result of the agreement with Covad Communications to offer DSL services over their network.

EBIT margin declined to 23.0% in 2002 from 32.8% in 2001 and 37.0% in 2000. The declining EBIT margins primarily reflect the impact of customers who substitute long distance calling with wireless and Internet service and remain AT&T Consumer Services customers as well as customers who migrate to optional calling plans and lower-priced products. These customers generate less revenue, while their billing, customer care and fixed costs remain. The 2002 margin was also negatively impacted by the DSL asset impairment charge. The 2001 margin decline was also impacted by a slight increase in marketing spending targeted at high-value customers, partially offset by the receipt of \$0.2 billion in 2001 from the settlement of disputes relating to obligations resulting from the sale of AT&T Universal Card Services to Citigroup in 1998.

Other Items

In 2002, capital additions decreased \$13 million, or 9.2%, compared with 2001. In 2001, capital additions decreased \$8 million, or 5.2%, compared with 2000.

Total assets declined \$0.5 billion to \$1.7 billion at December 31, 2002, compared with \$2.1 billion at December 31, 2001. This decline was primarily due to lower accounts receivable, reflecting lower revenue and slightly improved cash collections.

Corporate and Other

This group primarily reflects the results of corporate staff functions and the elimination of transactions between segments.

	<u>For the Years Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	<u>(Dollars in millions)</u>		
Revenue	\$ (258)	\$ (351)	\$ (352)
EBIT	(399)	(1,063)	1,163
Capital additions	63	150	1,594
	<u>At December 31,</u>		
	<u>2002</u>	<u>2001</u>	
	<u>(Dollars in millions)</u>		
Total assets	\$17,233	\$19,872	

Revenue

In 2002, Corporate and Other revenue was negative \$258 million, compared with negative \$351 million in 2001. The year-over-year change was primarily due to lower internal revenue with AT&T Wireless due to its split-off on July 9, 2001, partially offset by an increase in internal revenue with AT&T Broadband. In 2003, as

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a result of the AT&T Broadband spin-off, the elimination of internal revenue residing in Corporate and Other will decline significantly.

Revenue for Corporate and Other was essentially flat in 2001 compared with 2000, as lower internal revenue from AT&T Wireless due to its split-off in 2001 was offset by increased sales from AT&T Business Services to AT&T Broadband.

EBIT

In 2002, EBIT improved \$0.7 billion to a deficit of \$0.4 billion. The improvement was largely due to lower investment impairment charges of approximately \$1.4 billion, primarily related to our investments in Net2Phone and Time Warner Telecom in 2001. Also contributing to the EBIT improvement was lower business restructuring charges as well as lower transaction costs associated with AT&T's restructuring announced in October of 2000, totaling \$0.6 billion. These EBIT improvements were partially offset by lower net gains of \$0.7 billion driven by a \$0.5 billion tax-free gain recorded in 2001 associated with the disposal of a portion of AT&T's retained interest in AT&T Wireless. Also offsetting the EBIT improvements were a lower pension credit (income) of \$0.3 billion primarily driven by a lower long-term expected rate of return and the effects of lower actual plan assets, a \$0.2 billion impairment charge recorded in 2002 of certain leases of aircraft which are accounted for as leveraged leases, and a \$0.2 billion variance due to mark-to-market adjustments on derivative instruments.

EBIT declined \$2.2 billion to a deficit of \$1.1 billion in 2001 compared with 2000. The decline was largely due to \$1.5 billion of greater investment impairment charges in 2001, primarily for Net2Phone and Time Warner Telecom. Also contributing to the decline were higher restructuring and other charges and higher transaction costs associated with AT&T's restructuring announced in October 2000, totaling \$0.4 billion; and a lower pension credit (income) and higher postretirement expense of \$0.3 billion. These declines were partially offset by the \$0.5 billion gain associated with the disposal of a portion of AT&T's retained interest in AT&T Wireless.

Other Items

Capital additions decreased \$87 million in 2002 primarily due to a decline in the purchase of investments. Capital additions decreased \$1.4 billion in 2001 primarily as a result of our investment in Net2Phone in 2000.

Total assets decreased \$2.6 billion, to \$17.2 billion in 2002. The decrease was primarily driven by a lower cash balance at December 31, 2002, and a decrease in investments primarily due to mark-to-market adjustments, partially offset by derivative-related activity.

Financial Condition

	At December 31,	
	2002	2001
	(Dollars in millions)	
Total assets	\$55,272	\$165,481
Total liabilities	42,960	105,778
Total shareowners' equity	12,312	51,680

Total assets decreased \$110.2 billion, or 66.6%, to \$55.3 billion at December 31, 2002, compared with December 31, 2001. The November 18, 2002, spin-off of AT&T Broadband accounted for \$103.2 billion of the decrease. The decrease also reflects lower receivables of \$3.1 billion primarily driven by improved cash collections, the settlement of receivables from Concert in connection with the Concert unwind, and lower

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revenue. In addition, assets decreased as a result of a \$2.7 billion reduction in cash and the write-off of \$1.1 billion of assets associated with the impairment of our interest in AT&T Latin America.

Total liabilities decreased \$62.8 billion, or 59.4%, to \$43.0 billion at December 31, 2002, from \$105.8 billion at December 31, 2001. The November 18, 2002, spin-off of AT&T Broadband contributed \$48.9 billion to the decrease. Also contributing to the decrease in liabilities was \$11.6 billion in lower debt reflecting the pay-down of short-term debt and AT&T Broadband's assumption of \$3.5 billion of AT&T long-term debt in connection with its spin-off. In addition, total liabilities decreased as a result of the settlement of AT&T's obligation to purchase the publicly owned shares of AT&T Canada and due to the impairment of our interest in AT&T Latin America.

Minority interest of discontinued operations decreased \$3.3 billion at December 31, 2002, compared with December 31, 2001. The decrease was a result of the exchange or redemption of all TCI Pacific preferred shares for AT&T common stock and the November 18, 2002, spin-off of AT&T Broadband. Quarterly income preferred securities of discontinued operations decreased \$4.7 billion at December 31, 2002, compared with December 31, 2001, as these securities were converted into Comcast class A common stock in conjunction with the spin-off of AT&T Broadband.

Total shareowners' equity decreased \$39.4 billion, or 76.2%, to \$12.3 billion at December 31, 2002, from \$51.7 billion at December 31, 2001. This decrease was primarily due to a decline of \$26.6 billion in additional paid-in capital principally due to a \$31.0 billion reduction resulting from the spin-off of AT&T Broadband (including compensation expense triggered by the spin-off), partially offset by an increase of \$2.5 billion from the June 2002 common stock offering and \$2.1 billion from the exchange or redemption of all TCI Pacific preferred shares for AT&T common shares. Retained earnings decreased \$13.1 billion at December 31, 2002, compared with December 31, 2001, primarily due to the net (loss) from discontinued operations partially offset by a \$1.3 billion gain on the spin-off of AT&T Broadband.

During 2002, when AT&T declared its quarterly dividends to the AT&T Common Stock Group shareowners, the Company was in an accumulated deficit position. As a result, the Company reduced additional paid-in capital by \$0.6 billion, the entire amount of the dividends declared.

Liquidity

Cash Flows

	For the Years Ended December 31,		
	2002	2001	2000
	(Dollars in millions)		
Provided by operating activities of continuing operations	\$10,483	\$10,005	\$10,641
(Used in) investing activities of continuing operations	(1,429)	(4,295)	(32,678)
(Used in) provided by financing activities of continuing operations	(6,041)	(2,778)	23,745
(Used in) provided by discontinued operations	(5,679)	7,683	(2,746)
Net (decrease) increase in cash and cash equivalents	<u>\$ (2,666)</u>	<u>\$10,615</u>	<u>\$ (1,038)</u>

Net cash provided by *operating activities* of AT&T's continuing operations of \$10.5 billion for the year ended December 31, 2002, was generated primarily by \$11.4 billion of income from continuing operations, adjusted to exclude noncash income items and net gains on sales of businesses and investments, and a decrease in accounts receivable of \$0.7 billion reflecting cash collections and lower revenue. Partially offsetting these sources of cash were a net change in other operating assets and liabilities of \$1.4 billion due to lower tax liabilities as well as lower payroll and benefit-related liabilities.

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Net cash provided by operating activities of continuing operations of \$10.0 billion for the year ended December 31, 2001, primarily included \$11.8 billion of income from continuing operations, adjusted to exclude noncash income items and net gains on sales of businesses and investments, and a decrease in accounts receivable of \$0.9 billion due to lower revenue and strong cash collections in December 2001. Partially offsetting the cash provided were net changes in other operating assets and liabilities of \$2.1 billion due to tax payments, and a decrease in accounts payable of \$0.5 billion. Net cash provided by operating activities of continuing operations of \$10.6 billion for the year ended December 31, 2000, primarily included income from continuing operations, excluding noncash income items and the adjustment for net gains on sales of businesses and investments, of \$13.8 billion, partially offset by an increase in accounts receivable of \$2.4 billion due to an increase in the receivables from Concert and slow customer collections at AT&T Business Services, a decrease in accounts payable of \$0.6 billion and a net change in other assets and liabilities of \$0.1 billion.

AT&T's *investing activities* resulted in a net use of cash of \$1.4 billion in 2002, compared with \$4.3 billion in 2001 and \$32.7 billion in 2000. During 2002, AT&T spent \$3.9 billion on capital expenditures, paid \$3.4 billion to settle the AT&T Canada obligation and received a \$5.8 billion cash distribution from AT&T Broadband in conjunction with its spin-off. In 2001, AT&T spent \$5.8 billion on capital expenditures, and received approximately \$1.6 billion from the sales of investments. During 2000, AT&T used approximately \$23.7 billion for acquisitions of businesses, primarily MediaOne Group, Inc., and spent \$7.0 billion on capital expenditures.

During 2002, net cash used in *financing activities* was \$6.0 billion, compared with net cash used in financing activities of \$2.8 billion in 2001, and net cash provided by financing activities of \$23.7 billion in 2000. During 2002, AT&T made net payments of \$8.2 billion to reduce debt, paid dividends of \$0.6 billion, and received \$2.7 billion from the issuance of AT&T common stock, primarily due to the sale of 46 million shares in the second quarter. The proceeds from this stock sale, along with funds from other short-term sources, were used to satisfy AT&T's obligation to the AT&T Canada shareholders (see investing activities above).

During 2001, AT&T made net debt payments of \$6.5 billion, paid AT&T Wireless \$5.8 billion to settle an intercompany loan in conjunction with its split-off from AT&T, and paid dividends of \$0.5 billion. Partially offsetting these outflows in 2001 was the receipt of \$9.8 billion from the issuance of convertible preferred stock to NTT DoCoMo. During 2000, AT&T received \$10.3 billion from the AT&T Wireless Group tracking stock offering and had net borrowings of debt of \$17.0 billion. These sources of cash were partially offset by the payment of \$3.0 billion in dividends.

Working Capital and Other Sources of Liquidity

At December 31, 2002, our working capital ratio (current assets divided by current liabilities) was 1.32, reflecting the cash balance on hand as a result of cash received in conjunction with the spin-off of AT&T Broadband.

During the second and third quarters of 2002, AT&T renewed both its AT&T Business Services and AT&T Consumer Services customer accounts receivable securitization facilities. Together, the programs provide up to \$2.0 billion of available financing, limited by the eligible receivables balance, which varies from month to month. Proceeds from the securitization are recorded as a borrowing and included in short-term debt. At December 31, 2002, approximately \$0.2 billion was outstanding. The terms of these facilities have been extended to June (AT&T Business Services) and July (AT&T Consumer Services) of 2003.

At December 31, 2002, we had a \$3.0 billion 364-day credit facility available to us that was entered into on October 9, 2002. The credit facility contains a financial covenant that requires AT&T to meet a net debt-to-EBITDA ratio (as defined in the credit agreement) not exceeding 2.25 to 1.00 for four consecutive quarters

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ending on the last day of each fiscal quarter. It also contains a covenant that requires AT&T to maintain \$1.27 billion in unencumbered cash, cash equivalents and marketable securities. At December 31, 2002, we were in compliance with these covenants.

AT&T reduced its debt in 2002 as a result of the spin-off of AT&T Broadband on November 18, 2002. The third party debt of TCI and MediaOne Group, Inc. of \$15.0 billion was included in the net assets spun-off with AT&T Broadband. This debt was included in the liabilities of discontinued operations at December 31, 2001. At the time of spin-off, AT&T and AT&T Broadband settled approximately \$9.4 billion of intercompany debt and transaction-related costs. AT&T received a \$5.8 billion cash distribution from AT&T Broadband, which is reflected in the cash balance at December 31, 2002. The remainder of the intercompany debt and transaction-related costs was settled via a debt exchange. In the AT&T Broadband debt exchange, \$3.5 billion of outstanding AT&T notes were exchanged for notes that, upon completion of the spin-off of AT&T Broadband, became notes of AT&T Broadband and are unconditionally guaranteed by Comcast and certain of its subsidiaries. In addition, AT&T completed another exchange in which \$4.6 billion of outstanding AT&T notes were exchanged for new AT&T notes that remain solely obligations of AT&T and, upon completion of the spin-off of AT&T Broadband, have revised terms, including revised maturity dates and/or interest rates.

We anticipate funding our operations in 2003 primarily with cash and cash equivalents on hand as well as cash from operations. If economic conditions worsen or do not improve and/or competition and product substitution accelerate beyond current expectations, our cash flow from operations would decrease, negatively impacting our liquidity. However, we believe our access to the capital markets is adequate to provide the flexibility in funding our operations that we desire. Sources of liquidity include the commercial paper market, a \$2.4 billion universal shelf registration, the securitization program and the credit facility. However, we cannot provide any assurances that all of these sources of funding will be available at the time they are needed or in the amounts required.

Credit Ratings and Related Debt Implications

During 2002, AT&T's long-term debt ratings were lowered by Moody's and Fitch. None of AT&T's ratings are currently under review or on Credit Watch for further downgrade. As of December 31, 2002, our credit ratings were as follows:

<u>Credit Rating Agency</u>	<u>Short-Term Rating</u>	<u>Long-Term Rating</u>	<u>Outlook</u>
Standard & Poor's	A-2	BBB+	Stable*
Moody's	P-2	Baa2	Negative
Fitch Ratings.....	F-2	BBB+	Stable*

* Subsequent to December 31, 2002, the Outlook was changed to "Negative."

Our access to the capital markets as well as the cost of our borrowings is affected by our debt ratings. In 2002, as a result of the Moody's downgrade, the interest rate on \$10.0 billion of notes sold in November 2001, increased by 50 basis points effective with interest payment periods that began after November 15, 2002, for the majority of the notes. The additional interest expense in 2002 was approximately \$8 million and is estimated to be an additional \$50 million in 2003. Additional debt rating downgrades could require AT&T to pay higher rates on certain existing debt, prepay certain operating leases and post cash collateral for certain interest-rate and equity swaps if we are in a net payable position.

If our ratings were downgraded below investment grade by Standard & Poor's or Moody's, there are provisions in our securitization programs, which could require the outstanding balances to be paid by the collection of the receivables. We do not believe downgrades below investment grade are likely to occur.

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The holders of certain private debt with an outstanding balance of \$0.9 billion at December 31, 2002, have an annual put right to cause AT&T to repay the debt upon payment of an exercise fee. In exchange for the debt holders agreeing not to exercise their put right, AT&T posted a cash-collateralized letter of credit in 2002 totaling \$0.4 billion and expiring March 2005. The annual put right for 2003 expired on February 13, 2003, without exercise by the debt holders. The holders could accelerate repayment of the debt based on certain events such as the occurrence of unfavorable local law or regulation changes in its country of operation.

If AT&T's debt ratings are further downgraded, AT&T's access to the capital market may be restricted and/or such replacement financing may be more costly or have additional covenants than we had in connection with our debt at December 31, 2002. In addition, the market environment for financing in general, and within the telecommunications sector in particular, has been adversely affected by economic conditions and bankruptcies of other telecommunication providers. If the financial markets become more cautious regarding the industry/ratings category we operate in, our ability to obtain financing would be further reduced. This could negatively impact our ability to pursue acquisitions, make capital expenditures to expand our network or to pay dividends.

Cash Requirements

Our cash needs for 2003 will be primarily related to capital expenditures, repayment of debt and payment of dividends. We expect our capital expenditures for 2003 to be approximately \$3.3 billion to \$3.5 billion. On January 31, 2003, we completed the repurchase, with cash, of \$3.7 billion of notes with interest rates of 6.375% and 6.5% and maturities of 2004 and 2013. These notes were classified as long-term debt at December 31, 2002. In addition, in connection with the early retirement in February 2003, of exchangeable notes that are indexed to AT&T Wireless stock, we made cash payments of \$152 million to the debt holders, funded in part by \$72 million of proceeds from the sale of our remaining AT&T Wireless shares.

AT&T is not required to make cash contributions to its principle pension plans in 2003. However, based on the final valuation of private equities and real estate for 2002, cash contributions could be required in 2004.

Contractual Cash Obligations

The following summarizes AT&T's contractual cash obligations and commercial commitments at December 31, 2002, and the effect such obligations are expected to have on liquidity and cash flow in future periods.

<u>Contractual Obligations</u>	<u>Payments Due by Period</u>				
	<u>Total</u>	<u>Less than 1 Year</u>	<u>2-3 Years</u>	<u>4-5 Years</u>	<u>After 5 Years</u>
	(Dollars in millions)				
Long-term debt, including current maturities ^{(1),(2)}	\$19,988	\$5,470	\$2,368	\$4,201	\$7,949
Capital lease obligations	101	4	17	7	73
Operating leases ⁽³⁾	2,124	480	729	455	460
Unconditional purchase obligations ^{(4),(5),(6),(7)}	674	268	291	115	—
Total Contractual Cash Obligations	<u>\$22,887</u>	<u>\$6,222</u>	<u>\$3,405</u>	<u>\$4,778</u>	<u>\$8,482</u>

⁽¹⁾ We had long-term debt that was indexed to securities (monetized debt). The total balance of monetized debt of \$519 million at December 31, 2002, had scheduled maturity dates of 2005 and 2006. However, in February 2003, we redeemed those notes with a combination of shares and cash of \$152 million. The portion of debt that was settled in shares is excluded from the above table and the cash payments were included in "Less than 1 Year" in the above table.

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- (2) We had long-term debt, with original maturity dates of 2004 and 2013, with a carrying value of \$3.7 billion at December 31, 2002. This debt was settled in the first quarter of 2003 and included in "Less than 1 Year" in the above table. In connection with the settlement of this debt, we paid premiums of \$124 million, which are excluded from the above table.
- (3) Under certain real estate operating leases, we could be required to make payments to the lessors of up to \$447 million at the end of the lease term (lease terms range from 2004 through 2007). The actual amount paid, if any, would be reduced by amounts received by the lessor upon remarketing of the property. These amounts are excluded from the above table due to the uncertainty of the dollar amounts to be paid, if any, as well as the timing of such amounts.
- (4) AT&T Consumer Services has unconditional purchase obligations with multiple vendors to purchase a broad range of products and services, including the outsourcing of billing and customer care services, and the purchase of certain promotional items. Such obligations extend through 2005.
- (5) AT&T has contractual obligations to utilize network facilities from local exchange carriers with terms greater than one year. Since the contracts have no minimum volume requirements, and are based on an interrelationship of volumes and discounted rates, we assessed our minimum commitment based on penalties to exit the contracts, assuming we exited the contracts on December 31, 2002. At December 31, 2002, the penalties AT&T would have incurred to exit all of these contracts would have been \$2.1 billion. These amounts are excluded from the above table due to the uncertainty of the dollar amounts to be paid, if any, as well as the timing of such amounts.
- (6) AT&T has contractual obligations under two contracts that extend through 2006 for services that include computer application design, development, maintenance and testing as well as the operation of data centers that host many of the computer applications operated throughout AT&T. Payments under these contracts are based in part on the volume and type of services we require. Since AT&T can terminate either or both of these contracts for convenience at any time by paying a fee, we assessed our minimum commitment based on the termination for convenience fees, which decline each year during the term of the contracts. If we elect to exit both of these contracts, the maximum termination fees we would be obligated to pay in the year of termination would be approximately \$359 million in 2003, \$308 million in 2004, \$239 million in 2005, or \$164 million in 2006. These termination fees are excluded from the above table due to the uncertainty of the dollar amounts to be paid, if any, as well as the timing of such amounts.
- (7) AT&T has contractual obligations that extend through 2009 for services that include payroll and related human resource services. Payments under these contracts are based on level of service required and fluctuates based on volume. Since there is no minimum service requirement and we can exit the contract at any time by paying a termination fee, we assessed our minimum commitment based on these termination fees, assuming we terminated the contracts on December 31 of each year. Such termination fees would be approximately \$50 million in 2003, \$44 million in 2004, \$38 million in 2005, \$23 million in 2006, \$11 million in 2007 or \$3 million in 2008. These amounts are excluded from the above table due to the uncertainty of the dollar amounts to be paid, if any, as well as the timing of such amounts.

From time to time, we guarantee the debt of our subsidiaries, and, in connection with the separation of certain subsidiaries, these guarantees remained and we issued guarantees for certain debt and other obligations. These guarantees relate to our former subsidiaries AT&T Capital Corp., NCR, AT&T Wireless and AT&T Broadband.

We currently hold no collateral for such guarantees, and have not recorded corresponding obligations. We have been provided with cross-guarantees or indemnifications by third parties for certain of these guarantees. In the event that the financial condition of the parties to the various agreements deteriorates to the point at which they declare bankruptcy, other third parties to the agreements could look to us for payment.

<u>Other Commercial Commitments</u>	<u>Commitments by Period</u>				
	<u>Total Amounts Committed</u>	<u>Less than 1 Year</u>	<u>2-3 Years</u>	<u>4-5 Years</u>	<u>After 5 Years</u>
		<u>(Dollars in millions)</u>			
Guarantees of debt ⁽¹⁾	\$ 506	\$ —	\$ —	\$ —	\$506
Guarantees of other obligations ^{(2),(3)}	4,968	180	4,646	142	—
Total	<u>\$5,474</u>	<u>\$180</u>	<u>\$4,646</u>	<u>\$142</u>	<u>\$506</u>

- (1) Prior to the spin-off of AT&T Broadband, we had guaranteed certain debt of AT&T Broadband, which we continue to provide. Under the terms of the merger agreement between AT&T Broadband and Comcast, if Comcast does not call the debt in 2003, they must provide us with a letter of credit in the amount of \$500 million. In addition, Comcast has provided us with an indemnification for this debt.

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- ⁽²⁾ Prior to the spin-off of AT&T Broadband, we had guaranteed various obligations of AT&T Broadband, including operating leases for real estate, surety bonds, and equity hedges, which we continue to provide. Comcast has provided indemnifications for the full amount of these guarantees.
- ⁽³⁾ AT&T provides a guarantee of an obligation that AT&T Wireless has to DoCoMo. In connection with an investment DoCoMo made in AT&T Wireless, AT&T and AT&T Wireless agreed that under certain circumstances, including that AT&T Wireless fails to meet specific technological milestones by June 30, 2004 (revised to December 31, 2004, pursuant to an amended agreement between AT&T Wireless and DoCoMo), DoCoMo would have the right to require AT&T Wireless to repurchase its AT&T Wireless common stock for \$9.8 billion plus interest. In the event AT&T Wireless is unable to satisfy its entire obligation, AT&T is secondarily liable for up to \$3.65 billion, plus interest.

Risk Management

We are exposed to market risk from changes in interest and foreign exchange rates, as well as changes in equity prices associated with previously affiliated companies. In addition, we are exposed to market risk from fluctuations in the prices of securities, some of which we had monetized through the issuance of debt. On a limited basis, we use certain derivative financial instruments, including interest rate swaps, options, forwards, equity hedges and other derivative contracts, to manage these risks. We do not use financial instruments for trading or speculative purposes. All financial instruments are used in accordance with board-approved policies.

We enter into foreign currency contracts to minimize our exposure to risk of adverse changes in currency exchange rates. We are subject to foreign exchange risk for foreign-currency-denominated transactions, such as debt issued, recognized payables and receivables and forecasted transactions. At December 31, 2002, our foreign currency market exposures were principally Euros, Japanese yen, and Swiss francs.

The fair value of foreign exchange contracts is subject to the changes in foreign currency exchange rates. For the purpose of assessing specific risks, we use a sensitivity analysis to determine the effects that market risk exposures may have on the fair value of our financial instruments and results of operations. To perform the sensitivity analysis, we assess the risk of loss in fair values from the effect of a hypothetical 10% adverse change in the value of foreign currencies, assuming no change in interest rates.

For foreign exchange contracts outstanding at December 31, 2002 and 2001, assuming a hypothetical 10% appreciation of the U.S. dollar against foreign currencies from the prevailing foreign currency exchange rates, the fair value of the foreign exchange contracts would have decreased \$66 million and \$492 million, respectively. The decrease in the change from 2001 was primarily due to a \$5.3 billion decline in the notional amount of contracts outstanding. This decline was largely due to debt under the Euro Commercial Paper Program paid down in 2002, and the satisfaction of the obligation to purchase the outstanding shares of AT&T Canada in 2002. Because our foreign exchange contracts are entered into for hedging purposes, we believe that these losses would be largely offset by gains on the underlying transactions.

We have also entered into combined interest rate foreign currency contracts to hedge foreign-currency-denominated debt. At December 31, 2002 and 2001, assuming a hypothetical 10% appreciation in the U.S. dollar against foreign currencies from the prevailing foreign currency exchange rates, the fair value of the combined interest rate foreign currency contracts would have decreased \$0.5 billion and \$0.4 billion, respectively. Because our foreign exchange contracts are entered into for hedging purposes, we believe that these losses would be largely offset by gains on the underlying foreign-currency-denominated debt.

The model to determine sensitivity assumes a parallel shift in all foreign currency exchange rates, although exchange rates rarely move in the same direction. Additionally, the amounts above do not necessarily represent the actual changes in fair value we would incur under normal market conditions because all variables, other than the exchange rates, are held constant in the calculations.

We use interest rate swaps to manage the impact of interest rate changes on earnings and cash flows. We perform a sensitivity analysis on our interest rate swaps to assess the risk of changes in fair value. The model to

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determine sensitivity assumes a hypothetical 10% parallel shift in all interest rates. At December 31, 2002 and 2001, assuming a hypothetical 10% decrease in interest rates, the fair value of interest rate swaps would have decreased by \$1 million and \$2 million, respectively. We believe the decrease in fair value would be largely offset by an increase in the fair value of the underlying hedged debt.

As discussed above, we have also entered into combined interest rate foreign currency contracts to hedge foreign-currency-denominated debt. Assuming a hypothetical 10% increase in interest rates, the fair value of the contracts would have decreased by \$3 million at December 31, 2002, and by a negligible amount at December 31, 2001.

The fair value of our fixed-rate long-term debt is sensitive to changes in interest rates. Interest rate changes would result in gains or losses in the market value of the debt due to differences between the market interest rates and rates at the inception of the obligation. Assuming a 10% downward shift in interest rates at December 31, 2002 and 2001, the fair value of unhedged debt would have increased by \$0.7 billion and \$1.0 billion, respectively.

At December 31, 2002, we had certain notes, with embedded derivatives, which were indexed to the market price of equity securities we owned. Changes in the market prices of these securities resulted in changes in the fair value of the derivatives. Assuming a hypothetical 10% increase in the market price of these equity securities, the fair value of the collars would have decreased by \$46 million and \$112 million at December 31, 2002 and 2001, respectively. Because these collars hedged the underlying equity securities monetized, we believed that the decrease in the fair value of the collars would have been largely offset by increases in the fair value of the underlying equity securities. The changes in fair values referenced above do not represent the actual changes in fair value we would incur under normal market conditions because all variables other than the equity prices were held constant in the calculations.

We use equity hedges to manage our exposure to changes in equity prices associated with various equity awards of previously affiliated companies. Assuming a hypothetical 10% decrease in equity prices of these companies, the fair value of the equity hedges (net liability) would have increased by \$9 million at December 31, 2002, and by a negligible amount at December 31, 2001. Because these contracts are entered into for hedging purposes, we believe that the increase in fair value would be largely offset by decreases in the underlying liabilities.

In order to determine the changes in fair value of our various financial instruments, including options, equity collars and other equity awards, we use certain financial modeling techniques, including Black-Scholes. We apply rate sensitivity changes directly to our interest rate swap transactions and forward rate sensitivity to our foreign currency forward contracts.

The changes in fair value, as discussed above, assume the occurrence of certain market conditions, which could have an adverse financial impact on the Company. They do not consider the potential effect of changes in market factors that would result in favorable impacts to us, and do not represent projected losses in fair value that we expect to incur. Future impacts would be based on actual developments in global financial markets. We do not foresee any significant changes in the strategies used to manage interest rate risk, foreign currency rate risk or equity price risk in the near future.

New Accounting Pronouncements

In August 2001, the FASB issued *SFAS No. 143, "Accounting for Asset Retirement Obligations."* This standard requires that obligations that are legally enforceable and unavoidable, and are associated with the retirement of tangible long-lived assets, be recorded as liabilities when those obligations are incurred, with the amount of the liability initially measured at fair value. The offset to the initial asset retirement obligation is an increase in the carrying amount of the related long-lived asset. Over time, this liability is accreted to its future

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value, and the asset is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. SFAS No. 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. For AT&T, this means that the standard was adopted on January 1, 2003. AT&T currently includes, in its group depreciation rates, an amount related to the retirement costs for certain assets. However, such amounts are not legally enforceable or unavoidable; therefore, AT&T will be required to reverse the amount accrued in accumulated depreciation. As of January 1, 2003, AT&T will report approximately \$40 million as the cumulative effect of a change in accounting principles related to the adoption of SFAS No. 143. The impact of no longer including the cost of removal in the group depreciation rates for these assets, coupled with the cumulative effect impact on accumulated depreciation, will result in a decrease to depreciation expense in 2003. However, the costs incurred to remove these assets will be reflected as a cost in the period incurred as "Costs of services and products."

On June 28, 2002, the FASB issued *SFAS No. 146, "Accounting for Exit or Disposal Activities."* This statement addresses the recognition, measurement and reporting of costs that are associated with exit and disposal activities. This statement includes the restructuring activities that are currently accounted for pursuant to the guidance set forth in EITF 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)," costs related to terminating a contract that is not a capital lease and one-time benefit arrangements received by employees who are involuntarily terminated — nullifying the guidance under EITF 94-3. Under SFAS No. 146, the cost associated with an exit or disposal activity is recognized in the periods in which it is incurred rather than at the date the company committed to the exit plan. This statement is effective for exit or disposal activities initiated after December 31, 2002, with earlier application encouraged. Previously issued financial statements will not be restated. The provisions of EITF 94-3 shall continue to apply for exit plans initiated prior to the adoption of SFAS No. 146. Accordingly, the initial adoption of SFAS No. 146 will not have an effect on AT&T's results of operations, financial position or cash flows. Liabilities associated with future exit and disposal activities will not be recognized until actually incurred.

In December 2002, the FASB issued *SFAS No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure — an amendment of FASB Statement No. 123."* This standard provides alternate methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation and requires more prominent disclosure about the method used. This statement is effective for fiscal years ending after December 15, 2002. For AT&T, this means it is effective for December 31, 2002. Currently AT&T applies the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" and we do not expense our stock options. However, as previously announced, AT&T will begin expensing all stock options issued after January 1, 2003, and will continue to apply the disclosure-only provisions to stock options issued prior to January 1, 2003. This method of transition is in compliance with the provisions of SFAS No. 148. The adoption of the disclosure provisions of SFAS No. 148 will not have an impact on AT&T's results of operations, financial position or cash flows; however, the expensing of the stock options issued after January 1, 2003, will have a negative impact on our results of operations. (See note 2 to the Consolidated Financial Statements for the required disclosure under this standard.)

In November 2002, the FASB issued *FASB Interpretation No. (FIN) 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others."* FIN 45 requires that an entity issuing a guarantee (including those embedded in a purchase or sales agreement) must recognize, at the inception of the guarantee, a liability equal to the fair value of the guarantee. The recording of this liability is not dependent on the probability that the payments will be required. The offset to the liability will depend on the circumstances under which the guarantee was issued, but could include: cash/accounts receivable if it is a standalone transaction, net proceeds in a sales transaction, or expense if no compensation is received. FIN 45 also requires detailed information about each guarantee or group of guarantees even if the

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likelihood of making a payment is remote. The disclosure requirements of this interpretation are effective for financial statements of periods ending after December 15, 2002, which makes them effective for AT&T for December 31, 2002 (see note 9 to the Consolidated Financial Statements for the disclosures required under this interpretation). The recognition and measurement provisions of this Interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. FIN 45 could have an impact on the future results of AT&T depending on guarantees issued; however, at this time we do not believe that the adoption of this statement will have a material impact on our results of operations, financial position or cash flows.

In January 2003, the FASB issued *FIN 46, "Consolidation of Variable Interest Entities — an Interpretation of Accounting Research Bulletin (ARB) No. 51."* FIN 46 requires the primary beneficiary to consolidate a variable interest entity (VIE) if it has a variable interest that will absorb a majority of the entity's expected losses if they occur, receive a majority of the entity's expected residual returns if they occur, or both. FIN 46 applies immediately to VIEs created after January 31, 2003, and to VIEs in which the entity obtains an interest after that date. For VIEs acquired before February 1, 2003, the effective date for AT&T is July 1, 2003. AT&T is currently in the process of determining the impact of this statement on its results of operations, financial position and cash flows. The disclosures relating to our present involvement with possible VIEs and our maximum exposure to losses are included in note 18 to the Consolidated Financial Statements.

In November 2002, the EITF reached a consensus on *EITF 00-21, "Revenue Arrangements with Multiple Deliverables,"* related to the timing of revenue recognition for arrangements in which goods or services or both are delivered separately in a bundled sales arrangement. The EITF requires that when the deliverables included in this type of arrangement meet certain criteria they should be accounted for separately as separate units of accounting. This may result in a difference in the timing of revenue recognition but will not result in a change in the total amount of revenue recognized in a bundled sales arrangement. The allocation of revenue to the separate deliverables is based on the relative fair value of each item. If the fair value is not available for the delivered items then the residual method must be used. This method requires that the amount allocated to the undelivered items in the arrangement is their full fair value. This would result in the discount, if any, being allocated to the delivered items. This consensus is effective prospectively for arrangements entered into in fiscal periods beginning after June 15, 2003, which, for AT&T, is July 1, 2003. AT&T is currently evaluating the impact of this consensus on its results of operations, financial position and cash flows.

In January 2003, the EITF reached a consensus on *EITF 02-18, "Accounting for Subsequent Investments in an Investee after Suspension of Equity Method Loss Recognition."* This consensus states that if an additional investment, in whole or in part, represents the funding of prior losses, the investor should recognize previously suspended losses. This determination would be based on various factors including whether the investment results in an increased ownership percentage, the fair value of the consideration received is equivalent to the consideration paid and whether the investment is acquired from a third party or directly from an investee. If any of these provisions are met, the additional investment would generally not be considered as funding prior losses. When appropriate to recognize prior losses, the amount recognized would be limited to the amount of the additional investment determined to represent the funding of prior losses. The consensus will be effective for additional investments made after February 5, 2003.

Subsequent Events

In January 2003, AT&T early retired \$3.7 billion of long-term notes. In February 2003, AT&T redeemed exchangeable notes that were indexed to AT&T Wireless common stock and subsequently sold its remaining AT&T Wireless holdings. For further information on these items, see the contractual cash obligations table in the liquidity discussion.

REPORT OF MANAGEMENT

Management is responsible for the preparation, integrity and objectivity of the consolidated financial statements and all other financial information included in this report. Management is also responsible for maintaining a system of internal controls as a fundamental requirement for the operational and financial integrity of results. The financial statements, which reflect the consolidated accounts of AT&T Corp. and subsidiaries (AT&T) and other financial information shown, were prepared in conformity with generally accepted accounting principles. Estimates included in the financial statements were based on judgments of qualified personnel. To maintain its system of internal controls, management carefully selects key personnel and establishes the organizational structure to provide an appropriate division of responsibility. We believe it is essential to conduct business affairs in accordance with the highest ethical standards as set forth in the AT&T Code of Conduct. These guidelines and other informational programs are designed and used to ensure that policies, standards and managerial authorities are understood throughout the organization. Our internal auditors monitor compliance with the system of internal controls by means of an annual plan of internal audits. On an ongoing basis, the system of internal controls is reviewed, evaluated and revised as necessary in light of the results of constant management oversight, internal and independent audits, changes in AT&T's business and other conditions. Management believes that the system of internal controls, taken as a whole, provides reasonable assurance that (1) financial records are adequate and can be relied upon to permit the preparation of financial statements in conformity with generally accepted accounting principles, and (2) access to assets occurs only in accordance with management's authorizations.

The Audit Committee of the Board of Directors, which is composed of directors who are not employees, meets periodically with management, the internal auditors and the independent accountants to review the manner in which these groups of individuals are performing their responsibilities and to carry out the Audit Committee's oversight role with respect to auditing, internal controls and financial reporting matters. Periodically, both the internal auditors and the independent accountants meet privately with the Audit Committee and have access to its individual members at any time.

The consolidated financial statements in this annual report have been audited by PricewaterhouseCoopers LLP, Independent Accountants. Their audits were conducted in accordance with generally accepted auditing standards and include an assessment of the internal control structure and selective tests of transactions. Their report follows.



David W. Dorman
Chairman of the Board,
Chief Executive Officer



Thomas W. Horton
Senior Executive Vice President,
Chief Financial Officer

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareowners of AT&T Corp.:

In our opinion, based on our audits and the report of other auditors, the accompanying consolidated balance sheets and the related consolidated statements of operations, changes in shareowners' equity and of cash flows present fairly, in all material respects, the financial position of AT&T Corp. and its subsidiaries (AT&T) at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of AT&T's management; our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements for the year ended December 31, 2000 of Liberty Media Group, an equity method investee, which was acquired by AT&T on March 9, 1999. AT&T's financial statements include equity method earnings of \$1,488 million for the year ended December 31, 2000. Those statements were audited by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for Liberty Media Group, for the year ended December 31, 2000, is based solely on the report of the other auditors. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

As discussed in the notes to the financial statements, AT&T was required to adopt Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, effective January 1, 2002.



PRICEWATERHOUSECOOPERS LLP

New York, New York
January 23, 2003, except for Note 20,
as to which the date is February 28, 2003

AT&T CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Years Ended December 31,		
	2002	2001	2000
	Dollars in millions (except per share amounts)		
Revenue	\$ 37,827	\$42,197	\$46,850
Operating Expenses			
Access and other connection	10,790	12,085	13,139
Costs of services and products (excluding depreciation of \$3,391, \$2,954 and \$3,119 included below)	8,363	8,621	8,235
Selling, general and administrative	7,988	8,064	7,387
Depreciation and amortization	4,888	4,559	4,538
Net restructuring and other charges	1,437	1,036	758
Total operating expenses	33,466	34,365	34,057
Operating income	4,361	7,832	12,793
Other (expense) income, net	(77)	1,327	1,190
Interest (expense)	(1,448)	(1,493)	(1,503)
Income from continuing operations before income taxes, minority interest income, and net (losses) earnings related to equity investments	2,836	7,666	12,480
(Provision) for income taxes	(1,587)	(2,890)	(4,487)
Minority interest income	114	131	41
Equity (losses) earnings from Liberty Media Group	—	(2,711)	1,488
Net (losses) earnings related to other equity investments	(400)	(4,836)	10
Income (loss) from continuing operations	963	(2,640)	9,532
Net (loss) from discontinued operations (net of income tax benefits of \$6,014, \$3,715, and \$1,364)	(14,513)	(4,052)	(4,863)
Gain on disposition of discontinued operations (net of income tax benefit of \$61 in 2002)	1,324	13,503	—
(Loss) income before cumulative effect of accounting changes	(12,226)	6,811	4,669
Cumulative effect of accounting changes (net of income taxes of \$530 and \$(578))	(856)	904	—
Net (loss) income	(13,082)	7,715	4,669
Dividend requirements of preferred stock	—	(652)	—
Premium on exchange of AT&T Wireless tracking stock	—	(80)	—
(Loss) income attributable to common shareowners	<u>\$ (13,082)</u>	<u>\$ 6,983</u>	<u>\$ 4,669</u>
AT&T Common Stock Group — per basic share:			
Earnings (loss) from continuing operations	\$ 1.29	\$ (0.91)	\$ 11.54
(Loss) from discontinued operations	(19.44)	(5.60)	(7.09)
Gain on disposition of discontinued operations	1.77	18.53	—
Cumulative effect of accounting changes	(1.15)	0.49	—
AT&T Common Stock Group (loss) earnings	<u>\$ (17.53)</u>	<u>\$ 12.51</u>	<u>\$ 4.45</u>
AT&T Common Stock Group — per diluted share:			
Earnings (loss) from continuing operations	\$ 1.26	\$ (0.91)	\$ 11.01
(Loss) from discontinued operations	(18.95)	(5.60)	(6.76)
Gain on disposition of discontinued operations	1.73	18.53	—
Cumulative effect of accounting changes	(1.12)	0.49	—
AT&T Common Stock Group (loss) earnings	<u>\$ (17.08)</u>	<u>\$ 12.51</u>	<u>\$ 4.25</u>
AT&T Wireless Group — per basic and diluted share:			
Earnings	<u>\$ —</u>	<u>\$ 0.08</u>	<u>\$ 0.21</u>
Liberty Media Group — per basic and diluted share:			
(Loss) earnings — before cumulative effect of accounting changes	\$ —	\$ (1.05)	\$ 0.58
Cumulative effect of accounting changes	—	0.21	—
Liberty Media Group (loss) earnings	<u>\$ —</u>	<u>\$ (0.84)</u>	<u>\$ 0.58</u>

The notes are an integral part of the consolidated financial statements.

AT&T CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	At December 31,	
	2002	2001
	Dollars in millions	
ASSETS		
Cash and cash equivalents.....	\$ 8,014	\$ 10,680
Accounts receivable, less allowances of \$669 and \$754.....	5,286	7,153
Other receivables	173	1,431
Deferred income taxes	910	1,192
Other current assets	1,520	622
Current assets of discontinued operations	—	1,649
TOTAL CURRENT ASSETS	15,903	22,727
Property, plant and equipment, net	25,604	26,803
Goodwill, net of accumulated amortization in 2001 of \$564.....	4,626	5,314
Other purchased intangible assets, net of accumulated amortization of \$244 and \$190	556	661
Prepaid pension costs	3,596	3,329
Other assets	4,987	5,144
Non-current assets of discontinued operations	—	101,503
TOTAL ASSETS	\$ 55,272	\$165,481
LIABILITIES		
Accounts payable	\$ 3,819	\$ 4,156
Payroll and benefit-related liabilities	1,519	1,606
Debt maturing within one year	3,762	10,134
Other current liabilities	2,924	3,929
Current liabilities of discontinued operations	—	5,801
TOTAL CURRENT LIABILITIES	12,024	25,626
Long-term debt.....	18,812	24,025
Long-term benefit-related liabilities	4,001	3,459
Deferred income taxes	4,739	2,438
Other long-term liabilities and deferred credits	3,384	7,159
Non-current liabilities of discontinued operations	—	43,071
TOTAL LIABILITIES	42,960	105,778
Minority Interest of Discontinued Operations.....	—	3,303
Company-Obligated Convertible Quarterly Income Preferred Securities of Subsidiary Trust Holding Solely Subordinated Debt Securities of AT&T of Discontinued Operations	—	4,720
SHAREOWNERS' EQUITY		
AT&T Common Stock, \$1 par value, authorized 6,000,000,000 shares; issued and outstanding 783,037,580 shares (net of 171,801,716 treasury shares) at December 31, 2002 and 708,481,149 shares (net of 170,349,286 treasury shares) at December 31, 2001	783	708
Additional paid-in capital	28,163	54,798
Accumulated deficit	(16,566)	(3,484)
Accumulated other comprehensive loss	(68)	(342)
TOTAL SHAREOWNERS' EQUITY	12,312	51,680
TOTAL LIABILITIES AND SHAREOWNERS' EQUITY	\$ 55,272	\$165,481

The notes are an integral part of the consolidated financial statements.

AT&T CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNERS' EQUITY

	For the Years Ended December 31,		
	2002	2001	2000
	Dollars in millions		
AT&T Common Stock			
Balance at beginning of year	\$ 708	\$ 752	\$ 639
Shares issued (acquired), net:			
Under employee plans	6	3	1
For acquisitions	—	9	121
Settlement of put option	—	31	—
For exchange of AT&T Wireless tracking stock	—	(74)	—
For funding AT&T Canada obligation	46	—	—
Redemption of TCI Pacific preferred stock	10	—	—
Other	13	(13)	(9)
Balance at end of year	<u>783</u>	<u>708</u>	<u>752</u>
AT&T Wireless Group Common Stock			
Balance at beginning of year	—	362	—
Shares issued:			
For stock offering	—	—	360
Under employee plans	—	2	2
For exchange of AT&T Wireless tracking stock	—	438	—
Conversion of preferred stock	—	406	—
AT&T Wireless Group split-off	—	(1,208)	—
Balance at end of year	<u>—</u>	<u>—</u>	<u>362</u>
Liberty Media Group Class A Common Stock			
Balance at beginning of year	—	2,364	2,314
Shares issued (acquired), net:			
For acquisitions	—	—	62
Other	—	14	(12)
Liberty Media Group split-off	—	(2,378)	—
Balance at end of year	<u>—</u>	<u>—</u>	<u>2,364</u>
Liberty Media Group Class B Common Stock			
Balance at beginning of year	—	206	217
Shares issued (acquired), net	—	6	(11)
Liberty Media Group split-off	—	(212)	—
Other	—	—	—
Balance at end of year	<u>—</u>	<u>—</u>	<u>206</u>
Additional Paid-In Capital			
Balance at beginning of year	54,798	93,504	62,083
Shares issued (acquired), net:			
Under employee plans	328	291	100
For acquisitions	—	862	23,583
Settlement of put option	—	3,361	—
For funding AT&T Canada obligation	2,485	—	—
Redemption of TCI Pacific preferred stock	2,087	—	—
Other*	31	(1,054)	(2,804)
Proceeds in excess of par value from issuance of AT&T Wireless common stock	—	—	9,915
Gain on issuance of common stock by affiliates	—	20	530
Conversion of preferred stock	—	9,631	—
AT&T Wireless Group split-off	—	(20,955)	—
Liberty Media Group split-off	—	(30,768)	—

(continued on next page)

AT&T CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNERS' EQUITY (Continued)

	For the Years Ended December 31,		
	2002	2001	2000
	Dollars in millions		
AT&T Broadband spin-off	(31,032)	—	—
Exchange of AT&T Wireless tracking stock	—	(284)	—
Beneficial conversion value of preferred stock	—	295	—
Dividends declared — AT&T Common Stock Group	(569)	(265)	—
Other	35	160	97
Balance at end of year	<u>28,163</u>	<u>54,798</u>	<u>93,504</u>
Guaranteed ESOP Obligation			
Balance at beginning of year	—	—	(17)
Amortization	—	—	17
Balance at end of year	<u>—</u>	<u>—</u>	<u>—</u>
(Accumulated Deficit)/Retained Earnings			
Balance at beginning of year	(3,484)	7,408	6,712
Net (loss) income	(13,082)	7,715	4,669
Dividends declared — AT&T Common Stock Group	—	(275)	(2,485)
Dividends accrued — preferred stock	—	(652)	—
Premium on exchange of AT&T Wireless tracking stock	—	(80)	—
Treasury shares issued at less than cost	—	(7)	(1,488)
AT&T Wireless Group split-off	—	(17,593)	—
Balance at end of year	<u>(16,566)</u>	<u>(3,484)</u>	<u>7,408</u>
Accumulated Other Comprehensive (Loss)			
Balance at beginning of year	(342)	(1,398)	6,979
Other comprehensive income (loss)	266	1,742	(8,377)
AT&T Wireless Group split-off	—	72	—
Liberty Media Group split-off	—	(758)	—
AT&T Broadband spin-off	8	—	—
Balance at end of year	<u>(68)</u>	<u>(342)</u>	<u>(1,398)</u>
Total Shareowners' Equity	<u>\$ 12,312</u>	<u>\$ 51,680</u>	<u>\$103,198</u>
Summary of Total Comprehensive (Loss) Income:			
(Loss) income before cumulative effect of accounting changes	\$(12,226)	\$ 6,811	\$ 4,669
Cumulative effect of accounting changes	(856)	904	—
Net (loss) income	(13,082)	7,715	4,669
Other comprehensive income (loss) [net of income taxes of \$(169), \$(1,119), and \$5,348]	266	1,742	(8,377)
Comprehensive (Loss) Income	<u>\$(12,816)</u>	<u>\$ 9,457</u>	<u>\$ (3,708)</u>

AT&T accounts for treasury stock as retired stock.

We have 100 million authorized shares of preferred stock at \$1 par value.

* Other activity in 2001 and 2000 represents AT&T common stock received in exchange for entities owning certain cable systems.

The notes are an integral part of the consolidated financial statements.

AT&T CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,		
	2002	2001	2000
	Dollars in millions		
OPERATING ACTIVITIES			
Net (loss) income	\$(13,082)	\$ 7,715	\$ 4,669
Deduct:			
Loss from discontinued operations	(14,513)	(4,052)	(4,863)
Gain on disposition of discontinued operations	1,324	13,503	—
Cumulative effect of accounting changes — net of income taxes	(856)	904	—
Income (loss) from continuing operations	963	(2,640)	9,532
Adjustments to reconcile income (loss) from continuing operations to net cash provided by operating activities of continuing operations:			
Net gains on sales of businesses and investments	(30)	(1,231)	(734)
Cost investment impairment charges	146	531	7
Net restructuring and other charges	1,418	973	577
Depreciation and amortization	4,888	4,559	4,538
Provision for uncollectible receivables	1,058	884	925
Deferred income taxes	2,631	(1,338)	1,005
Net revaluation of certain financial instruments	8	(150)	—
Minority interest income	(114)	(131)	(41)
Equity losses (earnings) from Liberty Media Group	—	2,711	(1,488)
Net losses related to other equity investments	512	7,783	51
Decrease (increase) in receivables	707	888	(2,382)
Decrease in accounts payable	(175)	(508)	(585)
Net change in other operating assets and liabilities	(1,400)	(2,126)	(148)
Other adjustments, net	(129)	(200)	(616)
NET CASH PROVIDED BY OPERATING ACTIVITIES OF CONTINUING OPERATIONS	10,483	10,005	10,641
INVESTING ACTIVITIES			
Capital expenditures and other additions	(3,878)	(5,767)	(7,025)
Proceeds from sale or disposal of property, plant and equipment	468	73	555
Increase in other receivables	—	—	(981)
Investment distributions and sales	10	1,585	414
Investment contributions and purchases	(2)	(101)	(1,787)
Net dispositions (acquisitions) of businesses, net of cash disposed/acquired	(18)	15	(23,742)
Decrease in AT&T Canada obligation	(3,449)	—	—
Proceeds from AT&T Broadband	5,849	—	—
Increase in restricted cash	(442)	—	—
Other investing activities, net	33	(100)	(112)
NET CASH USED IN INVESTING ACTIVITIES OF CONTINUING OPERATIONS	(1,429)	(4,295)	(32,678)
FINANCING ACTIVITIES			
Proceeds from long-term debt issuances, net of issuance costs	79	11,392	739
Retirement of long-term debt	(1,091)	(725)	(688)
(Decrease) increase in short-term borrowings, net	(7,157)	(17,168)	16,973
Repayment of borrowings from AT&T Wireless	—	(5,803)	—
Issuance of convertible preferred securities and warrants	—	9,811	—
Issuance of AT&T common shares	2,684	224	99
Issuance of AT&T Wireless Group common shares	—	54	10,314
Net issuance (acquisition) of treasury shares	—	24	(581)
Dividends paid on common stock	(555)	(549)	(3,047)
Other financing activities, net	(1)	(38)	(64)
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES OF CONTINUING OPERATIONS	(6,041)	(2,778)	23,745
Net cash (used in) provided by discontinued operations	(5,679)	7,683	(2,746)
Net (decrease) increase in cash and cash equivalents	(2,666)	10,615	(1,038)
Cash and cash equivalents at beginning of year	10,680	65	1,103
Cash and cash equivalents at end of year	\$ 8,014	\$ 10,680	\$ 65

The notes are an integral part of the consolidated financial statements.

AT&T CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. AT&T Restructuring and Discontinued Operations

In connection with the restructuring of AT&T Corp. (AT&T or the "Company") announced on October 25, 2000, AT&T Broadband, AT&T Wireless, and Liberty Media Group have all been separated from AT&T.

AT&T Broadband, which was spun-off from AT&T on November 18, 2002, was accounted for as a discontinued operation pursuant to Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." In accordance with SFAS No. 144, prior period financial statements have been restated to reflect AT&T Broadband as a discontinued operation in all periods. AT&T Wireless, which was split-off from AT&T on July 9, 2001, was accounted for as a discontinued operation pursuant to Accounting Principles Board (APB) Opinion No. 30, "Reporting Results of Operations — Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." Since AT&T Wireless was separated in 2001, it was reflected as a discontinued operation in the prior year's financial statements. As discontinued operations, the revenue, costs and expenses and cash flows of AT&T Broadband and AT&T Wireless have been excluded from the respective captions in the Consolidated Statements of Operations and Consolidated Statements of Cash Flows, and have been reported through their respective dates of separation as "Net (loss) from discontinued operations" and as "Net cash (used in) provided by discontinued operations." In addition, the assets and liabilities of AT&T Broadband have been excluded from the respective captions in the Consolidated Balance Sheet at December 31, 2001, and have been reported as "Current assets of discontinued operations," "Non-current assets of discontinued operations," "Current liabilities of discontinued operations," "Non-current liabilities of discontinued operations," "Minority Interest of Discontinued Operations" and "Company-Obligated Convertible Quarterly Income Preferred Securities of Subsidiary Trust Holding Solely Subordinated Debt Securities of AT&T of Discontinued Operations."

AT&T Broadband

On November 18, 2002, AT&T spun-off AT&T Broadband, which was comprised primarily of the AT&T Broadband segment, to AT&T shareowners. Simultaneously, AT&T Broadband combined with Comcast Corporation (Comcast) to form new Comcast. The combination was accomplished through a distribution of stock to AT&T shareowners, who received 0.3235 (1.6175 adjusted for the 1-for-5 reverse stock split) of a share of Comcast Class A common stock for each share of AT&T they owned at market close on November 15, 2002, the record date. The Internal Revenue Service (IRS) ruled that the transaction qualified as tax-free for AT&T and its shareowners for U.S. federal income tax purposes, with the exception of cash received for fractional shares. Approximately 1.2 billion Comcast shares were issued to AT&T shareowners at a value of approximately \$31.1 billion, based on the Comcast stock price on November 18, 2002. AT&T shareowners received a 56% economic stake and a 66% voting interest in new Comcast.

In connection with the non-pro rata spin-off of AT&T Broadband, AT&T wrote up the net assets of AT&T Broadband to fair value. This resulted in a noncash gain of \$1.3 billion, which represented the difference between the fair value of the AT&T Broadband business at the date of the spin-off and AT&T's book value in AT&T Broadband, net of certain charges triggered by the spin-off and their related income tax effect. These charges included compensation expense due to the accelerated vesting of stock options as well as the enhancement of certain incentive plans. The gain was recorded as a "Gain on disposition of discontinued operations."

Revenue for AT&T's Broadband business (which included At Home Corporation, or "Excite@Home" through September 2001) was \$8.9 billion, \$10.1 billion and \$8.4 billion for 2002, 2001 and 2000, respectively. Net (loss) from discontinued operations before income taxes was \$(20.5) billion, \$(8.1) billion, and \$(7.1) billion for 2002, 2001, and 2000, respectively for the AT&T Broadband business. The loss for 2002

AT&T CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

included pretax impairment charges of \$16.5 billion (\$11.8 billion after taxes) relating to goodwill and franchise costs which was recorded in the second quarter of 2002.

Interest expense of \$359 million, \$333 million and \$463 million was allocated to discontinued operations in 2002, 2001 and 2000, respectively, based on the balance of intercompany debt between AT&T Broadband and AT&T. At the time of the spin-off of AT&T Broadband, this intercompany debt was settled via a \$5.8 billion cash distribution from AT&T Broadband and the exchange of \$3.5 billion of AT&T notes for notes of AT&T Broadband which are unconditionally guaranteed by Comcast and certain of its subsidiaries (see note 8).

At December 31, 2001, current assets of \$1.6 billion, non-current assets of \$101.5 billion (including net goodwill of \$19.4 billion), current liabilities of \$5.8 billion, non-current liabilities of \$43.1 billion, minority interest of \$3.3 billion, and company-obligated convertible quarterly income preferred securities of \$4.7 billion were attributable to the discontinued operations of the AT&T Broadband business. Current assets were primarily comprised of accounts receivable and investments, while non-current assets were primarily comprised of goodwill, franchise costs and investments. Current liabilities were primarily comprised of short-term debt, accounts payable and payroll and benefit-related liabilities, while non-current liabilities were primarily comprised of long-term debt and deferred income taxes.

The noncash impacts of the spin-off of AT&T Broadband include a reduction to assets of approximately \$84.3 billion, a reduction to liabilities of approximately \$48.8 billion, the reduction of minority interest of \$1.2 billion, the reduction of company-obligated convertible quarterly income preferred securities of subsidiary trust of \$4.7 billion, and a reduction to shareowners' equity of approximately \$29.6 billion, including the \$1.3 billion noncash gain on spin-off.

AT&T Wireless

On April 27, 2000, AT&T created a new class of stock and completed a public stock offering of 360 million shares, which represented 15.6% of AT&T Wireless Group tracking stock at a price of \$29.50 per share. This stock was intended to track the financial performance and economic value of AT&T's wireless services business. The net proceeds to AT&T, after deducting the underwriter's discount and related fees and expenses, were \$10.3 billion. AT&T allocated \$7.0 billion of the net proceeds to AT&T Wireless Group, which was used for acquisitions, network expansion, capital expenditures and general corporate purposes. AT&T utilized the remaining net proceeds of \$3.3 billion for general corporate purposes.

On May 25, 2001, AT&T completed an exchange offer of AT&T common stock for AT&T Wireless stock. Under the terms of the exchange offer, AT&T issued 1.176 shares (5.88 shares adjusted for the 1-for-5 reverse stock split) of AT&T Wireless Group tracking stock in exchange for each share of AT&T common stock validly tendered. A total of 372.2 million shares (74.4 million shares adjusted for the 1-for-5 reverse stock split) of AT&T common stock were tendered in exchange for 437.7 million shares of AT&T Wireless Group tracking stock. In conjunction with the exchange offer, AT&T recorded an \$80 million premium as a reduction to net income available to common shareowners. The premium represented the excess of the fair value of the AT&T Wireless Group tracking stock issued over the fair value of the AT&T common stock exchanged.

On July 9, 2001, AT&T completed the split-off of AT&T Wireless as a separate, independently traded company. All AT&T Wireless Group tracking stock was converted into AT&T Wireless common stock on a one-for-one basis, and 1,136 million shares of AT&T Wireless common stock held by AT&T were distributed to AT&T common shareowners on a basis of 0.3218 shares (1.609 shares adjusted for the 1-for-5 reverse stock split) of AT&T Wireless for each AT&T share outstanding. AT&T common shareowners received whole shares of AT&T Wireless common stock and cash payments for fractional shares. The IRS ruled that the transaction qualified as tax-free for AT&T and its shareowners for U.S. federal income tax purposes, with the

AT&T CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

exception of cash received for fractional shares. For accounting purposes, the deemed effective split-off date was June 30, 2001. The impact of operating results from July 1, 2001 through July 9, 2001, were deemed immaterial to our consolidated results. The split-off of AT&T Wireless resulted in a tax-free noncash gain of \$13.5 billion, which represented the difference between the fair value of the AT&T Wireless tracking stock at the date of the split-off and AT&T's book value in AT&T Wireless. This gain was recorded in 2001 as a "Gain on disposition of discontinued operations." At the time of split-off, AT&T retained approximately \$3.0 billion, or 7.3%, of AT&T Wireless common stock, about half of which was used in a debt-for-equity exchange in July 2001. The remaining portion of these holdings was monetized in October and December of 2001 through the issuance of debt that was exchangeable into AT&T Wireless shares (or their cash equivalent) at maturity (see notes 7 and 8).

Revenue for AT&T Wireless was \$6.6 billion for 2001 and \$10.4 billion for 2000. Income from discontinued operations before income taxes for AT&T Wireless was \$308 million for 2001 and \$844 million for 2000. Interest expense of \$153 million and \$330 million was allocated to AT&T Wireless discontinued operations in 2001 and 2000, respectively, based on the debt of AT&T that was attributable to AT&T Wireless.

The noncash impacts of the split-off of AT&T Wireless reflect the split-off of approximately \$39.7 billion of net assets which included a \$13.5 billion noncash gain.

Lucent Technologies Inc.

Net (loss) from discontinued operations for 2002 reflects an estimated loss on a litigation settlement associated with the business of Lucent Technologies Inc. (Lucent), which was spun-off from AT&T in 1996. Sparks, et al. v. AT&T and Lucent Technologies Inc. et al., was a class action lawsuit filed in 1996 in Illinois state court. The complaint sought damages on behalf of present and former customers based on a claim that the AT&T Consumer Products business (which became part of Lucent in 1996) and Lucent had defrauded and misled customers who leased telephones, resulting in payments in excess of the cost to purchase the telephones. AT&T and Lucent have denied any wrongdoing, but settled this matter to avoid the uncertainty and expense of protracted litigation. On August 9, 2002, a settlement proposal was submitted to and accepted by the court. In accordance with the separation and distribution agreement between AT&T and Lucent, AT&T's estimated proportionate share of the settlement and legal costs totaled \$45 million pretax (\$33 million after-tax), reflecting a fourth quarter adjustment to the initial estimate. Depending upon the number of claims submitted and accepted, the actual cost of the settlement to AT&T may be less than stated amounts, but it is not possible to estimate the amount at this time. While similar consumer class actions are pending in various state courts, the Illinois state court has held that the class it certified covers claims in the other state court class actions.

Summary

Following is a summary of net (loss) from discontinued operations, net of income taxes:

	For the Years Ended December 31,		
	2002	2001	2000
	(Dollars in millions)		
AT&T Broadband, net of income tax benefits of \$6,002, \$3,873 and \$1,671	\$(14,480)	\$(4,202)	\$(5,399)
AT&T Wireless, net of income taxes of \$(158) and \$(307) ...	—	150	536
Lucent Technologies Inc., net of income tax benefit of \$12	(33)	—	—
Net (loss) from discontinued operations, net of income taxes ..	<u>\$(14,513)</u>	<u>\$(4,052)</u>	<u>\$(4,863)</u>

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Liberty Media Corporation

As a result of our merger with Tele-Communications, Inc. (TCI) in 1999, we acquired Liberty Media Group (LMG). Although LMG was wholly owned, we accounted for it as an equity method investment since we did not have a controlling financial interest. On August 10, 2001, AT&T completed the split-off of Liberty Media Corporation (LMC) as an independent, publicly-traded company. AT&T redeemed each outstanding share of Class A and Class B LMG tracking stock for one share of Liberty Media Corporation's Series A and Series B common stock, respectively. The IRS ruled that the split-off of Liberty Media Corporation qualified as a tax-free transaction for AT&T, Liberty Media and their shareowners. The operating results of LMG through July 31, 2001, the deemed effective split-off date for accounting purposes, were reflected as "Equity (losses) earnings from Liberty Media Group." The impact of the operating results from August 1 through August 10, 2001, was deemed immaterial to our consolidated results. At the time of disposition, AT&T did not exit the line of business that Liberty Media Group operated in; therefore, at the time of its separation, Liberty Media Group was not accounted for as a discontinued operation.

Upon split-off, AT&T paid LMG \$803 million pursuant to a tax-sharing agreement related to TCI net operating losses generated prior to AT&T's merger with TCI. In addition, in 2002, AT&T received approximately \$114 million from LMG related to taxes pursuant to a tax-sharing agreement between LMG and AT&T Broadband, which existed prior to the TCI merger. At December 31, 2001, this receivable was included in "Accounts receivable."

Summarized results of operations for LMG were as follows:

	For the Seven Months Ended July 31, 2001	For the Year Ended December 31, 2000
	(Dollars in millions)	
Revenue	\$ 1,190	\$1,526
Operating (loss) income	(426)	436
(Loss) income from continuing operations before cumulative effect of accounting change	(2,711)	1,488
Cumulative effect of accounting change	545	—
Net (loss) income	(2,166)	1,488

2. Summary of Significant Accounting Policies*Consolidation*

The consolidated financial statements include all controlled subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Investments in majority-owned subsidiaries where control does not exist and investments in which we exercise significant influence but do not control (generally a 20% to 50% ownership interest) are accounted for under the equity method of accounting. Investments in which there is no significant influence (generally less than a 20% ownership interest) are accounted for under the cost method of accounting.

Foreign Currency Translation

For operations outside the United States that prepare financial statements in currencies other than the U.S. dollar, we translate income statement amounts at average exchange rates for the year, and we translate assets and liabilities at year-end exchange rates. We present these translation adjustments as a component of "Accumulated other comprehensive loss" within shareowners' equity. Gains and losses from foreign currency transactions are included in results of operations.

AT&T CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and revenue and expenses during the period reported. Actual results could differ from those estimates. Estimates are used when accounting for certain items such as allowances for doubtful accounts, depreciation and amortization, employee benefit plans, taxes, restructuring reserves and contingencies.

Revenue Recognition

We recognize long distance, local voice and data services revenue based upon minutes of traffic processed or contracted fee schedules. In addition, we record an estimated revenue reduction for adjustments to customer accounts. This estimate is based on a detailed analysis that compares accounts receivable aging at different points in time to determine the appropriate level of adjustments. We recognize other products and services revenue when the products are delivered and accepted by customers and when services are provided in accordance with contract terms. For contracts where we provide customers with an indefeasible right to use network capacity, we recognize revenue ratably over the stated life of the agreement.

Advertising and Promotional Costs

We expense costs of advertising and promotions as incurred. Advertising and promotional expenses were \$814 million, \$874 million and \$801 million in 2002, 2001 and 2000, respectively.

Income Taxes

The provision for income taxes is based on reported income before income taxes. Deferred income taxes are provided for the effect of temporary differences between the amounts of assets and liabilities recognized for financial reporting purposes and the amounts recognized for income tax purposes. Deferred tax assets and liabilities are measured using currently enacted tax laws and the effects of any changes in income tax laws are included in the provision for income taxes in the period of enactment. Valuation allowances are recognized to reduce deferred tax assets when it is more likely than not that the asset will not be realized. In assessing the likelihood of realization, we consider estimates of future taxable income, the character of income needed to realize future benefits and all available evidence. Investment tax credits are amortized as a reduction to the provision for income taxes over the useful lives of the assets that produced the credits.

Cash Equivalents

We consider all highly liquid investments with original maturities of generally three months or less to be cash equivalents.

Property, Plant and Equipment

We state property, plant and equipment at cost. Construction costs, labor and applicable overhead related to installations and interest during construction are capitalized. Costs of additions and substantial improvements to property, plant and equipment are capitalized. The costs of maintenance and repairs of property, plant and equipment are charged to operating expense. Depreciation is determined based upon the assets' estimated useful lives using either the group or unit method. The useful lives of communications and network equipment range from three to 15 years. The useful lives of other equipment ranges from three to seven years. The useful lives of buildings and improvements range from 10 to 40 years. The group method is used for most depreciable assets, including the majority of communications and network equipment. The unit method is primarily used for large computer systems, buildings and support assets. Under the group method, a specific

AT&T CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

asset group has an average life. A depreciation rate is developed based on the average useful life for the specific asset group. This method requires the periodic revision of depreciation rates. Under the unit method, assets are depreciated based on the useful life of the individual asset. When we sell or retire assets depreciated using the group method, the difference between the proceeds, if any, and the cost of the asset is charged or credited to accumulated depreciation, without recognition of a gain or loss. When we sell assets that were depreciated using the unit method, we include the related gains or losses in "Other (expense) income, net."

Property, plant and equipment is reviewed for impairment annually, or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If the total of the expected future undiscounted cash flows is less than the carrying value of the asset, a loss is recognized for the difference between the fair value and the carrying value of the asset.

We use accelerated depreciation methods for certain high-technology computer-processing equipment and digital equipment used in the telecommunications network, except for switching equipment placed in service before 1989, where a straight-line method is used. All other plant and equipment is depreciated on a straight-line basis.

Software Capitalization

Certain direct development costs associated with internal-use software are capitalized, including external direct costs of material and services, and payroll costs for employees devoting time to the software projects. These costs are included within "Other assets" and are amortized over a period not to exceed five years beginning when the asset is substantially ready for use. Costs incurred during the preliminary project stage, as well as maintenance and training costs, are expensed as incurred. AT&T also capitalizes initial operating-system software costs and amortizes them over the life of the associated hardware.

AT&T also capitalizes costs associated with the development of application software incurred from the time technological feasibility is established until the software is ready to provide service to customers. These capitalized costs are included in property, plant and equipment and are amortized over a useful life not to exceed five years.

Goodwill and Other Intangible Assets

Goodwill is the excess of the purchase price over the fair value of net assets acquired in business combinations accounted for under the purchase method. Beginning January 1, 2002, in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill and indefinite-lived intangible assets are no longer amortized, but instead are tested for impairment at least annually (see note 3). Intangible assets that have finite useful lives are amortized over their useful lives, which range from five to 20 years.

Derivative Financial Instruments and Hedging Activities

We use derivative financial instruments to mitigate market risk from changes in interest rates, foreign currency exchange rates and equity prices. Derivative financial instruments may be exchange-traded or contracted in the over-the-counter market and include swaps, options, warrants and forward contracts. We do not use derivative financial instruments for speculative purposes.

All derivatives are recognized on the balance sheet at fair value. Certain derivatives, at inception, are designated as hedges and evaluated for effectiveness at least quarterly throughout the hedge period. These derivatives are designated as either (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge), or (2) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge). All other derivatives are not formally designated for accounting purposes (undesignated). These derivatives, except for warrants, although undesignated for accounting purposes, are entered into to hedge economic risks.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

We record changes in the fair value of fair-value hedges, along with the changes in the fair value of the hedged asset or liability that is attributable to the hedged risk (including losses or gains on firm commitments), in "Other (expense) income, net."

We record changes in the fair value of cash-flow hedges, along with the recognized asset or liability, in "Other comprehensive income (loss)," net of income taxes, as a component of shareowners' equity, until earnings are affected by the variability of cash flows of the hedged transaction.

Changes in the fair value of undesignated derivatives are recorded in "Other (expense) income, net," along with the change in fair value of the underlying asset or liability.

We currently do not have any net investment hedges in a foreign operation.

We assess embedded derivatives to determine whether (1) the economic characteristics of the embedded instruments are not clearly and closely related to the economic characteristics of the remaining component of the financial instrument (the host instrument) and (2) whether a separate instrument with the same terms as the embedded instrument would meet the definition of a derivative instrument. When it is determined that both conditions exist, we designate the derivatives as described above, and recognize the derivative at fair value.

We formally document all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions.

We discontinue hedge accounting prospectively when (1) it is determined that the derivative is no longer effective in offsetting changes in the fair value of cash flows of a hedged item; (2) the derivative expires or is sold, terminated, or exercised; (3) it is determined that the forecasted hedged transaction will no longer occur; (4) a hedged firm commitment no longer meets the definition of a firm commitment, or (5) management determines that the designation of the derivative as a hedge instrument is no longer appropriate.

When hedge accounting is discontinued, the derivative is adjusted for changes in fair value through "Other (expense) income, net." For fair value hedges, the underlying asset or liability will no longer be adjusted for changes in fair value and any asset or liability recorded in connection with a firm commitment will be removed from the balance sheet and recorded in current period earnings. For cash flow hedges, gains and losses that were accumulated in "Other comprehensive income (loss)" as a component of shareowners' equity in connection with a forecasted transaction, will be recognized immediately in "Other (expense) income, net."

Stock-Based Compensation

As of December 31, 2002, AT&T had a Long-Term Incentive Program and an Employee Stock Purchase Plan, which are described more fully in note 12. We apply APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for our plans. Accordingly, no compensation expense has been recognized for our stock-based compensation plans other than for our performance-based and restricted stock awards, stock appreciation rights (SARs), and certain occasions when we have modified the terms of the stock option vesting schedule in conjunction with the 2001 split-off of AT&T Wireless and the 2002 spin-off of AT&T Broadband.

AT&T has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." If AT&T had elected to recognize compensation costs based on the fair value at the date of

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

grant of the awards, consistent with the provisions of SFAS No. 123, net income and earnings per share amounts would have been as follows:

For the Years Ended December 31,	AT&T Common Stock Group			AT&T Wireless Group	
	2002	2001	2000	2001	2000
	(Dollars in millions)				
Net (loss) income	\$(13,082)	\$9,114	\$3,105	\$ 35	\$ 76
Add: Stock-based employee compensation included in reported net (loss) income, net of tax	43	75	(156)	—	—
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of tax	(345)	(692)	(324)	(17)	(25)
Pro forma net (loss) income	<u>\$(13,384)</u>	<u>\$8,497</u>	<u>\$2,625</u>	<u>\$ 18</u>	<u>\$ 51</u>
Basic (loss) earnings per share	\$ (17.53)	\$12.51	\$ 4.45	\$0.08	\$0.21
Proforma basic (loss) earnings per share	\$ (17.93)	\$11.66	\$ 3.77	\$0.04	\$0.14
Diluted (loss) earnings per share	\$ (17.08)	\$12.51	\$ 4.25	\$0.08	\$0.21
Proforma diluted (loss) earnings per share	\$ (17.47)	\$11.66	\$ 3.60	\$0.04	\$0.14

The stock-based employee compensation (expense) income, net of tax, for AT&T Common Stock Group included in income (loss) from continuing operations was \$(55) million, \$(71) million and \$(7) million in 2002, 2001 and 2000, respectively, and included in discontinued operations was \$12 million, \$(4) million and \$163 million in 2002, 2001 and 2000, respectively. The amounts attributed to discontinued operations included income (expense), net of tax, of \$51 million, \$(2) million and \$166 million in 2002, 2001 and 2000, respectively, related to grants of SARs of affiliated companies held by certain employees subsequent to the TCI merger and prior to the AT&T Broadband spin-off. In addition, we entered into an equity hedge in 1999 to offset potential future compensation costs associated with these SARs. (Expense), net of tax, related to this hedge was \$(56) million, \$(10) million, and \$(200) million in 2002, 2001, and 2000, respectively.

Total stock-based employee compensation (expense), net of tax, determined under the fair value based method for all awards related to continuing operations was \$(288) million, \$(562) million and \$(315) million for 2002, 2001 and 2000, respectively, and related to discontinued operations was \$(57) million, \$(147) million and \$(34) million for 2002, 2001 and 2000, respectively.

Pro forma earnings (loss) for AT&T Common Stock Group from continuing operations was \$730 million, \$(1,152) million and \$7,736 million for 2002, 2001 and 2000, respectively, and from discontinued operations was \$(14,582) million, \$(4,213) million and \$(5,111) million for 2002, 2001 and 2000, respectively.

Pro forma earnings (loss) for AT&T Common Stock Group per basic share from continuing operations was \$0.98, \$(1.58) and \$11.10 for 2002, 2001 and 2000, respectively, and from discontinued operations was \$(19.53), \$(5.78) and \$(7.33) for 2002, 2001 and 2000, respectively.

Pro forma earnings (loss) for AT&T Common Stock Group per diluted share from continuing operations was \$0.96, \$(1.58) and \$10.59 for 2002, 2001 and 2000, respectively, and from discontinued operations was \$(19.04), \$(5.78) and \$(6.99) for 2002, 2001 and 2000, respectively.

The pro forma effect on net loss from discontinued operations for AT&T Common Stock Group for 2002 includes expense of \$28 million due to the accelerated vesting of AT&T stock options held by AT&T Broadband employees at the date of spin-off. The pro forma effect on net loss from discontinued operations for

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

AT&T Common Stock Group for 2001 includes expense of \$10 million due to the conversion of AT&T common stock options in connection with the split-off of AT&T Wireless, and also includes expense of \$12 million due to the accelerated vesting of AT&T Wireless stock options held by AT&T employees at the date of the split-off.

The pro forma effect on net loss from continuing operations available to common shareowners for 2001 includes expense of \$40 million due to the conversion of AT&T common stock options in connection with the split-off of AT&T Wireless, and also includes expense of \$163 million due to the accelerated vesting of AT&T Wireless stock options held by AT&T employees at the date of split-off.

Issuance of Common Stock by Affiliates

Changes in our proportionate share of the underlying equity of a subsidiary or equity method investee, which result from the issuance of additional equity securities by such entity, are recognized as increases or decreases to additional paid-in capital in the Consolidated Statements of Shareowners' Equity.

Concentrations

As of December 31, 2002, other than the guarantee issued in connection with the split-off of AT&T Wireless (see note 9), we do not have any significant concentration of business transacted with a particular customer, supplier, lender or former affiliate that could, if suddenly adversely impacted, severely impact our operations. We also do not have a concentration of available sources of labor, services or other rights that could, if suddenly eliminated, severely impact our operations. We invest our cash with many high-quality credit institutions.

Reclassifications and Restatements

We reclassified and restated certain amounts for previous years to conform to the 2002 presentation.

3. Impacts of Recently Adopted Accounting Pronouncements

SFAS No. 142, "Goodwill and Other Intangible Assets"

Effective January 1, 2002, AT&T adopted SFAS No. 142, "Goodwill and Other Intangible Assets." Upon adoption, goodwill was tested for impairment by comparing the fair value of our reporting units to their carrying values. As of January 1, 2002, the fair value of the reporting units' goodwill exceeded their carrying value, and therefore no impairment loss was recognized. Franchise costs were tested for impairment as of January 1, 2002, by comparing the fair value to the carrying value (at the market level). An impairment loss of \$856 million, net of taxes of \$530 million, was recorded relating to the discontinued operation of AT&T Broadband in the first quarter of 2002. At December 31, 2002, this amount is included in the "Cumulative effect of accounting changes" in the Consolidated Statements of Operations.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The table below presents the impact of SFAS No. 142 on net (loss) income and (loss) earnings per share, had the standard been in effect on January 1, 2000:

For the Years Ended December 31,	AT&T Common Stock Group			AT&T Wireless Group		Liberty Media Group	
	2002	2001	2000	2001	2000	2001	2000
	(Dollars in millions, except per share amounts)						
Net (loss) income:							
Reported income (loss) from continuing operations	\$ 963	\$ 71	\$8,044	\$ —	\$ —	\$(2,711)	\$1,488
Dividend requirements of preferred stock	—	(652)	—	—	—	—	—
Premium on exchange of AT&T Wireless tracking stock	—	(80)	—	—	—	—	—
Reported income (loss) from continuing operations available to common shareowners	963	(661)	8,044	—	—	(2,711)	1,488
Add back amortization, net of tax:							
Goodwill	—	175	149	—	—	350	568
Equity method excess basis	—	37	37	—	—	346	654
Franchise costs	—	—	—	—	—	4	8
Adjusted income (loss) from continuing operations available to common shareowners	963	(449)	8,230	—	—	(2,011)	2,718
Reported (loss) income from discontinued operations	(14,513)	(4,087)	(4,939)	35	76	—	—
Add back discontinued operations amortization, net of tax	—	1,588	1,705	36	27	—	—
Gain on disposition of discontinued operations	1,324	13,503	—	—	—	—	—
Cumulative effect of accounting changes	(856)	359	—	—	—	545	—
Adjusted net (loss) income available to common shareowners	\$(13,082)	\$10,914	\$4,996	\$ 71	\$ 103	\$(1,466)	\$2,718
Basic (loss) earnings per share:							
Reported basic earnings (loss) per share from continuing operations	\$ 1.29	\$ (0.91)	\$11.54	\$ —	\$ —	\$ (1.05)	\$ 0.58
Add back amortization, net of tax:							
Goodwill	—	0.24	0.21	—	—	0.14	0.22
Equity method excess basis	—	0.05	0.05	—	—	0.13	0.25
Franchise costs	—	—	—	—	—	—	0.01
Adjusted basic earnings (loss) per share from continuing operations	1.29	(0.62)	11.80	—	—	(0.78)	1.06
Reported (loss) earnings from discontinued operations	(19.44)	(5.60)	(7.09)	0.08	0.21	—	—
Add back discontinued operations amortization, net of tax	—	2.18	2.45	0.08	0.08	—	—
Gain on disposition of discontinued operations	1.77	18.53	—	—	—	—	—
Cumulative effect of accounting changes	(1.15)	0.49	—	—	—	0.21	—
Adjusted basic (loss) earnings per share	\$ (17.53)	\$ 14.98	\$ 7.16	\$0.16	\$0.29	\$ (0.57)	\$ 1.06
Diluted (loss) earnings per share:							
Reported diluted earnings (loss) per share from continuing operations	\$ 1.26	\$ (0.91)	\$11.01	\$ —	\$ —	\$ (1.05)	\$ 0.58

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For the Years Ended December 31,	AT&T Common Stock Group			AT&T Wireless Group		Liberty Media Group	
	2002	2001	2000	2001	2000	2001	2000
	(Dollars in millions, except per share amounts)						
Add back amortization, net of tax:							
Goodwill	—	0.24	0.20	—	—	0.14	0.22
Equity method excess basis	—	0.05	0.05	—	—	0.13	0.25
Franchise costs	—	—	—	—	—	—	0.01
Adjusted diluted earnings (loss) per share from continuing operations	1.26	(0.62)	11.26	—	—	(0.78)	1.06
Reported (loss) earnings from discontinued operations	(18.95)	(5.60)	(6.76)	0.08	0.21	—	—
Add back discontinued operations amortization, net of tax	—	2.18	2.34	0.08	0.08	—	—
Gain on disposition of discontinued operations	1.73	18.53	—	—	—	—	—
Cumulative effect of accounting changes	(1.12)	0.49	—	—	—	0.21	—
Adjusted diluted (loss) earnings per share.....	\$ (17.08)	\$ 14.98	\$ 6.84	\$ 0.16	\$ 0.29	\$ (0.57)	\$ 1.06

Emerging Issues Task Force (EITF) Issue 01-9, "Accounting For Consideration Given by a Vendor to a Customer"

During 2002, the Emerging Issues Task Force (EITF) reached a consensus on Issue 01-9, "Accounting for Consideration Given by a Vendor to a Customer," that cash incentives given to customers should be characterized as a reduction of revenue when recognized in the income statement, unless an identifiable benefit is received in exchange. Prior to this consensus, cash incentives to acquire customers were recorded as advertising and promotion expense within selling, general and administrative expenses. These cash incentives are now recorded as a reduction of revenue and prior periods have been reclassified to conform to this presentation. The amounts reclassified as a reduction of revenue for the years ended December 31, 2001 and 2000, were \$236 million and \$250 million, respectively. Net income was not affected by this reclassification.

SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets"

On January 1, 2002, AT&T adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS No. 144 applies to all long-lived assets, including discontinued operations, and consequently amends APB Opinion No. 30. The initial adoption had no impact on AT&T's results of operations, financial position or cash flows.

Adoption of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities"

Effective January 1, 2001, AT&T adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and its corresponding amendments under SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. The adoption of SFAS No. 133 on January 1, 2001, resulted in a pretax cumulative-effect increase to income of \$1,482 million (\$904 million after-tax); \$581 million (\$359 million after-tax) was attributable to AT&T Group (other than LMG), and \$901 million (\$545 million after-tax) was attributable to LMG.

AT&T Group's cumulative-effect increase to net income of \$359 million was comprised of \$130 million related to continuing operations primarily attributable to warrants held in both public and private companies,

AT&T CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and \$229 million related to discontinued operations primarily attributable to embedded and non-embedded net purchase options related to indexed debt instruments.

Upon adoption, AT&T Group, as permitted by SFAS No. 133, reclassified certain securities from "available-for-sale" to "trading." This reclassification resulted in the recognition, in earnings, of losses previously recorded within "Accumulated other comprehensive loss." A portion of the loss (\$1.6 billion pretax; \$1.0 billion after-tax) was recorded as part of the cumulative effect of adoption. This loss completely offset a gain on the indexed debt obligation that had been considered a hedge of Comcast, Microsoft and Vodafone available-for-sale securities. The reclassification of securities also resulted in a pretax charge of \$1.2 billion (\$0.7 billion after-tax) recorded in "Net (loss) from discontinued operations," in the Consolidated Statements of Operations.

LMG's cumulative-effect increase to income of \$545 million was primarily attributable to separately recording the embedded call option obligations associated with LMG's senior exchangeable debentures. Also included in the cumulative-effect was \$87 million previously included in "Accumulated other comprehensive loss" primarily related to changes in the fair value of LMG's warrants and options to purchase certain available-for-sale securities.

4. Supplementary Financial Information

Supplementary Income Statement Information

	For the Years Ended December 31,		
	2002	2001	2000
	(Dollars in millions)		
Included in Selling, General and Administrative Expenses:			
Research and development expenses	\$ 254	\$ 274	\$ 313
Other (Expense) Income, Net:			
Aircraft leveraged-lease write-downs	\$(244)	\$ —	\$ —
Cost investment impairment charges	(146)	(531)	(7)
Net revaluation of certain financial instruments	(8)	150	—
Investment-related income	116	285	435
Settlements associated with businesses disposed of	107	154	—
Net gains on sales of businesses and investments	30	1,231	734
Miscellaneous, net	68	38	28
Total other (expense) income, net	\$ (77)	\$1,327	\$1,190

Supplementary Balance Sheet Information

	At December 31,	
	2002	2001
	(Dollars in millions)	
Property, Plant and Equipment:		
Communications, network and other equipment	\$48,169	\$47,552
Buildings and improvements	8,129	7,969
Land and improvements	327	370
Total property, plant and equipment	56,625	55,891
Accumulated depreciation	31,021	29,088
Property, plant and equipment, net	\$25,604	\$26,803

AT&T CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	<u>AT&T Business Services</u>	<u>AT&T Consumer Services</u>	<u>Total</u>
	(Dollars in millions)		
Goodwill:			
Balance at December 31, 2001	\$5,244	\$70	\$5,314
Write-off of goodwill of AT&T Latin America	(777)	—	(777)
Translation adjustment	91	—	91
Other	(2)	—	(2)
Balance at December 31, 2002	<u>\$4,556</u>	<u>\$70</u>	<u>\$4,626</u>

	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net</u>
	(Dollars in millions)		
Intangible Assets:			
Amortizable purchased intangible assets at December 31, 2002:			
Customer lists and relationships	\$557	\$132	\$425
Other	<u>243</u>	<u>112</u>	<u>131</u>
Total intangible assets	<u>\$800</u>	<u>\$244</u>	<u>\$556</u>

The amortization expense associated with purchased intangible assets for the year ended December 31, 2002, was approximately \$83 million. Amortization expense for purchased intangible assets is estimated to be approximately \$65 million for the year ending December 31, 2003, \$50 million for the year ending December 31, 2004, and \$45 million for each of the years ending December 31, 2005, 2006, and 2007.

Leveraged Leases:

We lease to third parties airplanes, energy-producing facilities and transportation equipment under leveraged leases having original terms of 10 to 30 years, expiring in various years from 2004 through 2020. The investment in leveraged leases is primarily included in "Other assets." Following is a summary of our investment in leveraged leases:

	<u>At December 31,</u>	
	<u>2002</u>	<u>2001</u>
	(Dollars in millions)	
Rental receivables (net of nonrecourse debt*)	\$ 476	\$ 635
Estimated unguaranteed residual values	483	720
Unearned income	(211)	(297)
Allowance for credit losses	<u>(23)</u>	<u>(28)</u>
Investment in leverage leases (included in "Other assets")	725	1,030
Deferred taxes	<u>932</u>	<u>1,063</u>
Net investment	<u>\$ (207)</u>	<u>\$ (33)</u>

* The rental receivables are net of nonrecourse debt of \$1.4 billion and \$2.0 billion at December 31, 2002 and 2001, respectively.

AT&T CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Supplementary Shareowners' Equity Information

	For the Years Ended December 31,		
	2002	2001	2000
	(Dollars in millions)		
Other Comprehensive Income (Loss):			
Net foreign currency translation adjustment [net of taxes of \$(82), \$160 and \$181] ⁽¹⁾	\$ 132	\$ (250)	\$ (309)
Net revaluation of certain financial instruments:			
Unrealized (losses) gains [net of taxes of \$340, \$(343) and \$4,686] ⁽²⁾	(550)	475	(7,317)
Recognition of previously unrealized losses (gains) on available-for-sale securities [net of taxes of \$(539), \$(950) and \$480] ⁽³⁾	869	1,535	(750)
Net minimum pension liability adjustment (net of taxes of \$112, \$14 and \$1)	(185)	(18)	(1)
Total other comprehensive income (loss)	<u>\$ 266</u>	<u>\$1,742</u>	<u>\$(8,377)</u>

⁽¹⁾ Includes LMG's foreign currency translation adjustments, net of taxes of \$149 in 2001 through July 31, 2001, and \$202 in 2000.

⁽²⁾ Includes LMG's unrealized gains (losses) on available-for-sale securities, net of taxes of \$(1,286) in 2001 through July 31, 2001, and \$6,117 in 2000.

⁽³⁾ See below for a summary of the "Recognition of previously unrealized losses (gains) on available-for-sale securities" and the Statement of Operations line items impacted.

Summary of Recognition of Previously Unrealized Losses (Gains) on Available-For-Sale Securities and the Statement of Operations Line Items Impacted

	For the Years Ended December 31,					
	2002		2001		2000	
	Pretax	After-tax	Pretax	After-tax	Pretax	After-tax
	(Dollars in millions)					
AT&T GROUP:						
Other (expense) income, net:						
Other-than-temporary investment impairments	\$ 148	\$ 91	\$ 475	\$ 293	\$ —	\$ —
Other derivative activity	28	17	—	—	—	—
Sales of various securities	—	—	(238)	(147)	(433)	(267)
Income from discontinued operations:						
Other-than-temporary investment impairments	1,232	761	510	315	290	179
Reclassification of securities to "trading" in conjunction with the adoption of SFAS No. 133*	—	—	1,154	713	—	—
Sales of various securities	—	—	555	343	(43)	(27)
LIBERTY MEDIA GROUP:						
Earnings (losses) from Liberty Media Group:						
Sales of various securities	—	—	173	105	(1,044)	(635)
Cumulative effect of accounting change*	—	—	(144)	(87)	—	—
Total recognition of previously unrealized losses (gains) on available-for-sale securities	<u>\$1,408</u>	<u>\$869</u>	<u>\$2,485</u>	<u>\$1,535</u>	<u>\$(1,230)</u>	<u>\$(750)</u>

* See note 3 for detailed discussion.

AT&T CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Supplementary Cash Flow Information

	For the Years Ended December 31,		
	2002	2001	2000
(Dollars in millions)			
Interest payments, net of capitalized interest of \$61, \$121 and \$143	\$1,532	\$1,537	\$1,420
Income tax (receipts) payments	(814)	1,441	3,379

5. Earnings per Common Share and Potential Common Share

During 2001 and 2000, in addition to AT&T Common Stock, the AT&T Wireless Group and Liberty Media Group tracking stocks were outstanding. The tracking stocks represented an interest in the economic performance of the net assets of each of the respective groups. The earnings attributable to AT&T Wireless Group and Liberty Media Group were excluded from the earnings attributable to the AT&T Common stock group. On July 9 and August 10, 2001, AT&T Wireless and Liberty Media Group, respectively, were separated from AT&T and the tracking stocks were redeemed (see note 1).

Income (loss) attributable to the different classes of AT&T common stock is as follows:

	AT&T Common Stock Group			AT&T Wireless Group			Liberty Media Group		
	For the Years Ended December 31,								
	2002	2001	2000	2002	2001	2000	2002	2001	2000
	(Dollars in millions)								
Income (loss) from continuing operations before cumulative effect of accounting change	\$ 963	\$ 71	\$ 8,044	\$—	\$—	\$—	\$—	\$(2,711)	\$1,488
Dividend requirements of preferred stock ...	—	(652)	—	—	—	—	—	—	—
Premium on exchange of AT&T Wireless tracking stock	—	(80)	—	—	—	—	—	—	—
Income (loss) from continuing operations attributable to common shareowners	963	(661)	8,044	—	—	—	—	(2,711)	1,488
(Loss) income from discontinued operations	(14,513)	(4,087)	(4,939)	—	35	76	—	—	—
Gain on disposition of discontinued operations	1,324	13,503	—	—	—	—	—	—	—
Cumulative effect of accounting changes ...	(856)	359	—	—	—	—	—	545	—
Net (loss) income attributable to common shareowners	\$(13,082)	\$ 9,114	\$ 3,105	\$—	\$35	\$76	\$—	\$(2,166)	\$1,488

AT&T Common Stock Group

On November 18, 2002, a 1-for-5 reverse stock split of AT&T common stock as approved by shareowners on July 10, 2002, was effected. Shares (except shares authorized) and per share amounts were restated to reflect the stock split on a retroactive basis.

Basic earnings per common share (EPS) is computed by dividing income attributable to common shareowners by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution (considering the combined income and share impact) that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The potential issuance of common stock is assumed to occur at the beginning of the year, and the incremental shares are included using the treasury stock method, which assumes the proceeds (after-tax) from exercise are used by the Company to purchase common stock at the average market price during the period. The incremental shares (difference between the shares assumed to be issued and the shares assumed to be

AT&T CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

purchased), to the extent they would have been dilutive, are included in the denominator of the diluted EPS calculation.

A reconciliation of the share components for AT&T Common Stock Group basic to diluted EPS calculations is as follows:

	For the Years Ended December 31,		
	2002 ⁽¹⁾	2001 ^{(1),(2)}	2000 ⁽¹⁾
	(Shares in millions)		
Weighted-average common shares	746	729	697
<i>Effect of dilutive securities:</i>			
Stock options	1	—	4
Preferred stock of subsidiary	3	—	8
Convertible quarterly income preferred securities	16	—	14
Excite@Home Put Options	—	—	8
Weighted-average common shares and potential common shares	<u>766</u>	<u>729</u>	<u>731</u>

⁽¹⁾ For 2002, 2001 and 2000, no adjustments were made to income for the computation of diluted EPS.

⁽²⁾ As AT&T reported a loss from its continuing operations for 2001, the effects of including incremental shares are antidilutive; therefore, both basic and diluted EPS reflect the same calculation.

Preferred Stock of Subsidiary

Pursuant to the AT&T Broadband and Comcast merger agreement, AT&T was required to redeem the outstanding TCI Pacific Communications, Inc. Class A Senior Cumulative Exchangeable Preferred Stock (TCI Pacific preferred stock) for AT&T common stock. All outstanding shares of TCI Pacific preferred stock were either exchanged or redeemed for AT&T common stock during 2001 and 2002 (see note 10). At December 31, 2001, the carrying value of TCI Pacific preferred stock was included in "Minority Interest of Discontinued Operations." Dividends were included in "Net (loss) from discontinued operations" for 2002, 2001 and 2000.

Convertible Quarterly Income Preferred Securities (Quarterly Preferred Securities)

On June 16, 1999, AT&T Finance Trust I, a wholly owned subsidiary of AT&T, completed the private sale of 100 million shares of 5.0% cumulative quarterly income preferred securities (quarterly preferred securities) to Microsoft Corporation. Such securities were convertible into AT&T common stock. However, in connection with the AT&T Broadband spin-off (see note 1), Comcast assumed the quarterly preferred securities and Microsoft agreed to convert these preferred securities into shares of Comcast common stock. At December 31, 2001, these securities were included in "Company-Obligated Convertible Quarterly Income Preferred Securities of Subsidiary Trust Holding Solely Subordinated Debt Securities of AT&T of Discontinued Operations." Dividends were included in "Net (loss) from discontinued operations" for 2002, 2001 and 2000.

AT&T Wireless Group

Basic EPS from discontinued operations for AT&T Wireless Group for 2001 through June 30, 2001, the deemed effective split-off date for accounting purposes, and from April 27, 2000, the stock offering date, through December 31, 2000, was computed by dividing income attributable to AT&T Wireless Group by the weighted-average number of shares outstanding of AT&T Wireless Group of 438 million and 361 million, respectively.

AT&T CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Liberty Media Group

Basic (loss) earnings per share for LMG was computed by dividing (loss) income attributable to LMG by the weighted-average number of LMG shares outstanding of 2,582 million in 2001 through July 31, 2001, the deemed effective split-off date for accounting purposes, and 2,572 million in 2000. Potentially dilutive securities, including fixed and nonvested performance awards and stock options, have not been factored into the dilutive calculations because past history indicated that these contracts were generally settled in cash.

6. Net Restructuring and Other Charges

In 2002, net restructuring and other charges were \$1,437 million which included a \$1,029 million charge for the impairment of the net assets of our consolidated subsidiary, AT&T Latin America. In December 2002, the AT&T Board of Directors approved a plan for AT&T to sell its approximate 95% voting stake in AT&T Latin America in its current condition. On December 31, 2002, we signed a non-binding term sheet for the sale of our shares within one year for a nominal amount. As a result of this plan, we classified AT&T Latin America as an asset held for sale at fair market value, in accordance with SFAS No. 144. Consequently, there are approximately \$160 million of assets (principally cash and accounts receivable) included in Other Current Assets and approximately \$160 million of liabilities (principally secured short-term debt) included in Other Current Liabilities. The \$1,029 million charge to write the assets and liabilities down to their fair values was reported within our AT&T Business Services segment.

Also included in net restructuring and other charges was a \$204 million impairment charge related to certain Digital Subscriber Line (DSL) assets (including internal-use software, licenses, and property, plant & equipment) that will not be utilized by AT&T as result of changes to our "DSL build" strategy. Instead of building DSL capabilities in all geographic areas initially targeted, we have signed an agreement with Covad Communications to offer DSL services over their network. As a result, the assets in these areas were impaired. This charge was reported within our AT&T Consumer Services segment.

In 2002, AT&T recorded net business restructuring charges of \$204 million. These activities consisted of new exit plans totaling \$377 million and reversals of \$173 million. The new plans primarily consisted of \$334 million for employee separation costs (\$28 million of which was recorded as a pension liability associated with management employees to be separated in 2002 which will be funded from the pension trust) and \$39 million of facility closing reserves. Slightly more than 4,800 employees will be separated in conjunction with these exit plans, approximately one-half of which are management employees and one-half are non-management employees. The majority of these employee separations will be involuntary. Approximately 14% of the employees affected by these exit plans had left their positions by December 31, 2002, and we expect those remaining to leave their positions by the end of 2003.

The \$173 million reversal primarily consisted of \$124 million of employee separation costs (approximately \$48 million of which was reversed from the pension liability) and \$26 million related to prior plan facility closings that were deemed to be no longer necessary. The reversals were primarily due to management's determination that the restructuring plan established in the fourth quarter of 2001 for certain areas of AT&T Business Services, including network services, needed to be modified given current industry conditions, as well as the redeployment of certain employees to different functions within the Company.

AT&T CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table displays the activity and balances of the restructuring reserve account:

	Type of Cost			Total
	Employee Separations	Facility Closings	Other	
	(Dollars in millions)			
Balance at January 1, 2000	\$ 150	\$ 239	\$ 21	\$ 410
Additions	442	2	62	506
Deductions	(350)	(67)	(47)	(464)
Balance at December 31, 2000	242	174	36	452
Additions	474	166	12	652
Deductions	(230)	(36)	(29)	(295)
Balance at December 31, 2001	486	304	19	809
Additions	306	78	—	384
Deductions	(413)	(99)	(16)	(528)
Balance at December 31, 2002	<u>\$ 379</u>	<u>\$ 283</u>	<u>\$ 3</u>	<u>\$ 665</u>

In addition to the new exit plans recorded during 2002, total additions for 2002 in the table above also includes \$39 million facility closing reserves recorded by Concert in 2001 and transferred to AT&T during 2002 as part of the unwind of that joint venture.

Deductions reflect cash payments of \$366 million, \$249 million and \$410 million for 2000, 2001 and 2002, respectively. These payments included cash termination benefits of \$254 million, \$202 million and \$328 million, for 2000, 2001 and 2002, respectively, which were primarily funded through cash from operations. In 2000, 2001 and 2002, reserves of \$98 million, \$13 million and \$9 million, respectively, were transferred out of the restructuring liability to long-term liability accounts as a result of exiting managers deferring severance payments, primarily related to executives. Also included in 2001 and 2002 deductions are reversals of prior business restructuring reserves of \$33 million and \$109 million, respectively. The business restructuring plans of 2000 and 2001 were substantially complete as of December 31, 2001 and 2002, respectively.

During 2001, net restructuring and other charges were \$1,036 million which were primarily comprised of \$862 million for employee separations, of which \$388 million related to benefits to be paid from pension assets as well as pension and postretirement curtailment losses, and \$166 million for facility closings. These charges were slightly offset by the reversal of \$33 million related to business restructuring plans announced in the fourth quarter 1999 and the first quarter 2000 (of which \$15 million related to employee separations and \$18 million related to contract terminations).

The charge covered separation costs for approximately 10,000 employees, approximately one-half of whom were management employees and one-half were non-management employees. More than 9,000 employee separations related to involuntary terminations and the remaining 1,000 were voluntary.

During 2000, we recorded \$758 million of net restructuring and other charges which included \$586 million for employee separations, of which \$144 million primarily related to pension and postretirement curtailment losses, \$91 million related to the government-mandated disposition of AT&T Communications (U.K.) Ltd., which would have competed directly with Concert and \$62 million of network lease and other contract termination costs associated with penalties incurred as part of notifying vendors of the termination of these contracts during the year.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The charge covered separation costs for approximately 6,100 employees, approximately one-half of whom were management employees and one-half were non-management employees. Approximately 5,500 of the employee separations were related to involuntary terminations and approximately 600 related to voluntary terminations.

7. Investments

Equity Method Investments

We have investments in various companies and partnerships that are accounted for under the equity method of accounting and included within "Other assets." Under the equity method, investments are stated at initial cost, and are adjusted for subsequent contributions and our share of earnings, losses and distributions as well as declines in value that are "other than temporary." At December 31, 2002 and 2001, we had equity investments of \$135 million and \$313 million, respectively. Distributions from equity investments totaled \$5 million, \$25 million and \$13 million for the years ended December 31, 2002, 2001 and 2000, respectively.

Summarized combined financial information for investments accounted for under the equity method that were significant to AT&T's financial results in 2001 is as follows:

For the Years Ended December 31,	Concert ⁽¹⁾		AT&T Canada			Other Equity Investments ⁽²⁾	
	2001	2000	2002	2001	2000	2001	2000
	(Dollars in millions)						
Revenue	\$ 6,189	\$7,748	\$ 947	\$1,000	\$1,001	\$3,813	\$11,751
Operating (loss) income	(3,574)	329	(853)	(226)	(225)	86	542
(Loss) income from continuing operations before extraordinary items & cumulative effect of accounting changes	(3,609)	103	(1,247)	(521)	(351)	(18)	307
Net (loss) income	\$ (3,609)	\$ 103	\$ (2,220)	\$ (518)	\$ (351)	\$ (20)	\$ 260
At December 31,	2001		2002	2001		2001	
	(Dollars in millions)						
Current assets	\$ 3,744		\$ 386	\$ 391		\$ 171	
Non-current assets	1,758		496	2,577		645	
Current liabilities	4,296		3,152	256		179	
Non-current liabilities	76		41	2,963		589	
Redeemable preferred stock	—		—	—		7	
Minority interest	—		—	—		—	

⁽¹⁾ The Concert joint venture was unwound in April 2002; therefore, financial information for 2002 is not applicable.

⁽²⁾ AT&T did not have any individually significant equity investments in 2002 and on a combined basis such investments were not significant to AT&T's 2002 financial results.

Concert

On April 1, 2002, Concert, our 50% owned joint venture with British Telecommunications plc (BT), was officially unwound and the venture's assets and customer accounts were distributed back to the parent companies, as agreed to in 2001. Under the partnership termination agreement, each of the partners generally reclaimed the customer contracts and assets that were initially contributed to the joint venture, including international transport facilities and gateway assets. In addition, AT&T assumed certain other assets that BT originally contributed to the joint venture.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In 2001, the agreement to dissolve the Concert venture impacted AT&T's intent and ability to hold its investment in Concert; therefore, AT&T recorded a \$1.8 billion after-tax impairment charge (\$2.9 billion pretax) included in "Net (losses) related to other equity investments." The charge related to the difference between the fair market value of the net assets AT&T was to receive in the transaction and the carrying value of AT&T's investment in Concert. Certain items reserved for in 2001 were favorably settled resulting in a \$60 million after-tax reversal in 2002, recorded within "Net (losses) earnings related to other equity investments."

AT&T Canada

At December 31, 2002, AT&T had an approximate 31% ownership interest in AT&T Canada. Pursuant to a 1999 merger agreement, AT&T had a commitment to purchase, or arrange for another entity to purchase, the publicly owned shares of AT&T Canada for the Back-end Price, which was the greater of the contractual floor price or the fair market value. The floor price accreted 4% each quarter, commencing on June 30, 2000.

In 2002 and 2001, AT&T recorded charges reflecting the estimated loss on this commitment. The charges represented the difference between the underlying value of the publicly owned AT&T Canada shares and the price AT&T had committed to pay for them, including the 4% accretion of the floor price. After-tax charges of \$0.3 billion (\$0.5 billion pretax) and \$1.8 billion (\$3.0 billion pretax) were recorded within "Net (losses) related to other equity investments" for 2002 and 2001, respectively. At December 31, 2001, this liability of \$3.0 billion was included in "Other long-term liabilities and deferred credits."

During 2002, AT&T arranged for third parties (Tricap Investment Corporation and CIBC Capital Partners) to purchase the remaining 69% equity in AT&T Canada. As part of this agreement, AT&T agreed to fund the purchase price on behalf of the third parties. Tricap and CIBC Partners made a nominal payment to AT&T upon completion of the transaction. Although AT&T held an approximate 31% ownership interest in AT&T Canada throughout 2002, it did not record equity earnings or losses since its investment balance was written down to zero largely through losses generated by AT&T Canada. Subsequent to December 31, 2002, AT&T entered into an agreement to dispose of its stake in AT&T Canada. In February 2003, pursuant to that agreement, AT&T disposed of substantially all of its AT&T Canada shares.

Impairments — Equity Investments

Declines in value of equity method investments judged to be other-than-temporary are recorded in "Net (losses) related to other equity investments." In 2002 and 2001, we recorded impairment charges on equity method investments of \$0.3 billion after-tax (\$0.5 billion pretax), and \$4.3 billion after-tax (\$7.0 billion pretax), respectively.

The 2002 charges primarily related to AT&T Canada and the 2001 charges primarily related to AT&T Canada and Concert, as discussed above. In addition, in 2001, we recorded an impairment charge on our investment in Net2Phone, Inc. (Net2Phone) of \$0.7 billion after-tax (\$1.1 billion pretax). This charge resulted from the deterioration of market valuations of Internet-related companies. In October 2001, AT&T contributed its investment in Net2Phone to NTOP Holdings, LLC (NTOP), and received ownership in NTOP. At December 31, 2001 AT&T retained an approximate 10% interest in NTOP, which was accounted for as a cost method investment. It was subsequently sold in December 2002.

Cost Method Investments

At December 31, 2002 and 2001, we had cost method investments included in "Other assets" of \$0.6 billion and \$1.6 billion, respectively. Under the cost method, earnings are recognized only to the extent distributions are received from the accumulated earnings of the investee. Distributions received in excess of accumulated earnings are recognized as a reduction of our investment balance. The Company's cost

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

investments are classified as available-for-sale and are reported at fair value, with unrealized gains and losses, net of tax, recorded as a separate component of "Other comprehensive income (loss)" in shareowners' equity. At December 31, 2002 and 2001, approximately \$0.5 billion and \$1.3 billion, respectively, of these investments were indexed to certain long-term debt instruments (see note 8).

Impairments — Cost Investments

Declines in value of available-for-sale securities, judged to be other-than-temporary, are recorded in "Other (expense) income, net." During 2002 and 2001, we believed that certain investments would not recover our cost basis in the foreseeable future given the significant decline in stock prices, the length of time these investments had been below market, and industry specific issues. Accordingly, we believed the declines in value were other-than-temporary and, as a result, recorded investment impairment charges on such securities of \$0.1 billion after-tax (\$0.1 billion pretax) and \$0.3 billion after-tax (\$0.5 billion pretax) for 2002 and 2001, respectively, consisting primarily of charges related to Time Warner Telecom in both years. In addition, during 2002, we recorded a pretax impairment charge of \$0.6 billion related to our holdings in AT&T Wireless, which is monetized by debt indexed to the value of the AT&T Wireless shares (see note 8). The debt contains an embedded derivative that is designated as a cash flow hedge. At the time we recognized the other-than-temporary decline in the value of AT&T Wireless as an expense, as permitted by SFAS No. 133, we also recognized, in earnings, the previously unrecognized gain on the embedded derivative of \$0.6 billion pretax, resulting in no net income impact.

AT&T Wireless Group

On July 9, 2001, AT&T completed the split-off of AT&T Wireless (see note 1). At that time, AT&T retained an approximate 7.3% interest in AT&T Wireless common stock. In 2001, we recorded a \$0.5 billion tax-free gain associated with the disposal of a portion of this ownership interest in a debt-for-equity exchange in "Other (expense) income, net."

In February 2003, AT&T redeemed exchangeable notes that were indexed to AT&T Wireless common stock. The notes were settled with 78.6 million AT&T Wireless shares (see note 8). Subsequently, AT&T sold its remaining AT&T Wireless shares (approximately 12.2 million shares) for \$72 million in cash, resulting in a gain of \$22 million.

Japan Telecom Co. Ltd

On April 27, 2001, AT&T completed the sale of its 10% stake in Japan Telecom Co. Ltd to Vodafone for \$1.35 billion in cash. The proceeds from the transaction were split evenly between AT&T and AT&T Wireless Group since AT&T Wireless Group held approximately one-half of AT&T's investment. The transaction resulted in a pretax gain of approximately \$0.5 billion recorded in "Other (expense) income, net" and a pretax gain of approximately \$0.5 billion recorded in "Net (loss) from discontinued operations."

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Debt Obligations

Debt Maturing within One Year

	<u>At December 31,</u>	
	<u>2002</u>	<u>2001</u>
	<u>(Dollars in millions)</u>	
Commercial paper	\$1,091	\$ 5,087
Short-term notes	1,086	3,970
Currently maturing long-term debt	1,581	955
Other	4	122
Total debt maturing within one year	<u>\$3,762</u>	<u>\$10,134</u>
Weighted-average interest rate of short-term debt	3.7%	5.0%

Securitizations

During 2002, AT&T renewed both its AT&T Business Services and AT&T Consumer Services customer accounts receivable securitization facilities, the terms of which have been extended to June (AT&T Business Services) and July (AT&T Consumer Services) of 2003. Together, the 2002 programs provide up to \$2.0 billion of available financing, limited by monthly eligible receivable balances, which vary from month to month. At December 31, 2002, the available financing was collateralized by \$4.6 billion of accounts receivable. Approximately \$0.2 billion and \$2.3 billion was outstanding at December 31, 2002 and 2001, respectively, and was included in "Short-term notes" in the table above. Under the program, accounts receivable are sold on a discounted, revolving basis, to special-purpose, wholly-owned and fully consolidated subsidiaries of AT&T, which assign interests in such receivables to unrelated third-party financing entities.

Credit Facility

At December 31, 2002, we had a \$3.0 billion 364-day credit facility available to us that was entered into on October 9, 2002. The credit facility contains a financial covenant that requires AT&T to meet a net debt-to-EBITDA ratio (as defined in the credit agreement) not exceeding 2.25 to 1.00 for four consecutive quarters ending on the last day of each fiscal quarter. It also contains a covenant that requires AT&T to maintain \$1.27 billion in unencumbered cash, cash equivalents and marketable securities. At December 31, 2002, we were in compliance with these covenants.

AT&T CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Long-Term Debt

<u>Debentures and Notes</u>		<u>At December 31,</u>	
		<u>2002⁽¹⁾</u>	<u>2001⁽¹⁾</u>
<u>Interest Rates⁽²⁾</u>	<u>Maturities</u>	<u>(Dollars in millions)</u>	
4.59% - 6.00%	2004 - 2009	\$ 1,455	\$ 6,760
6.06% - 6.50%	2004 - 2029	6,678	4,960
6.75% - 7.50%	2004 - 2006	2,449	4,459
7.75% - 8.85%	2003 - 2031	6,796	5,328
9.90% - 19.95% ⁽³⁾	2004 - 2004	13	21
Variable rate	2003 - 2054	3,012	3,440
Total debentures and notes		20,403	24,968
Other		105	162
Unamortized discount, net		(115)	(150)
Total long-term debt		20,393	24,980
Less: Currently maturing long-term debt		1,581	955
Net long-term debt		<u>\$18,812</u>	<u>\$24,025</u>

⁽¹⁾ Debt amounts are included within the range of interest rates that are applied at each respective balance sheet date. See below for discussion on interest rate changes that occurred during 2002.

⁽²⁾ The actual interest paid on our debt obligations may have differed from the stated amount due to our entering into interest rate swap contracts to manage our exposure to interest rate risk and our strategy to reduce finance costs (see note 9).

⁽³⁾ Interest rates greater than 10% are related to \$8 million in bank loans held by AT&T Latin America in 2001. In 2002, AT&T Latin America is classified as an "asset held for sale," and accordingly its associated liabilities, including debt, was recorded at fair value and included in "Other current liabilities" at December 31, 2002 (see note 6).

The following table shows maturities at December 31, 2002, of the \$20,393 million in total long-term obligations:

<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>Later Years</u>
<u>(Dollars in millions)</u>					
\$1,581	\$2,437	\$1,185	\$4,328	\$296	\$10,566

In connection with the spin-off of AT&T Broadband, AT&T completed two debt exchanges. In the AT&T Broadband debt exchange, \$3.5 billion of outstanding AT&T notes (with interest rates ranging from 6.0% to 8.63%) were exchanged for notes that, upon completion of the spin-off of AT&T Broadband, became notes of AT&T Broadband and are unconditionally guaranteed by Comcast and certain of its subsidiaries.

Also, \$4.6 billion of outstanding long-term AT&T notes (with fixed interest rates ranging from 5.63% to 8.0%, and maturities of 2004, 2025 and 2029) were exchanged for new AT&T notes (with fixed interest rates ranging from 6.38% to 8.6%, and maturities of 2004, 2013 and 2025) that upon completion of the spin-off of AT&T Broadband, have revised terms, including revised maturity dates and/or interest rates.

As a result of a long-term debt rating downgrade by Moody's, the interest rate on approximately \$10.0 billion of notes (with interest rates ranging from 6.0% to 8.0%) sold in November 2001, increased by 50 basis points effective with interest payment periods that begin after November 15, 2002, for the majority of the notes.

The holders of certain private debt with an outstanding balance of \$0.9 billion at December 31, 2002, have an annual put right to cause AT&T to repay the debt upon payment of an exercise fee. In exchange for the debt holders agreeing to not exercise their put right for 2002, AT&T posted a cash-collateralized letter of

AT&T CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

credit in 2002, totaling \$0.4 billion, and expiring in March, 2005. The \$0.4 billion is considered restricted cash and is included in "Other assets" at December 31, 2002. The annual put right in 2003 expired on February 13, 2003, without exercise by the debt holders. The debt holders could accelerate repayment of the debt based on certain events such as the occurrence of unfavorable local law or regulation changes in its country of operation.

On January 31, 2003, AT&T completed the early retirement of approximately \$1,152 million and \$2,590 million long-term notes, with interest rates of 6.375% and 6.50%, due in March 2004 and March 2013, respectively. The notes were repurchased with cash and resulted in a loss of \$178 million recorded in "Other (expense) income, net" in the first quarter of 2003.

Exchangeable Notes

During 2001, we issued long-term debt (exchangeable notes) that was indexed to AT&T Wireless common stock and, at AT&T's option, was mandatorily redeemable with a number of shares of AT&T Wireless common stock that was equal to the underlying shares multiplied by an exchange ratio, or its cash equivalent. The notes were accounted for as indexed debt instruments because the carrying value of the debt was dependent upon the fair market value of the underlying securities. In addition, the notes contained embedded derivatives that required separate accounting. The economic characteristics of the embedded derivatives (i.e. equity-like features) were not clearly and closely related to those of the host instruments (a debt security). As a result, the embedded derivatives were separated from the host debt instrument for valuation purposes and were carried at fair value within the host debt instrument. The embedded derivatives for these exchangeable notes were designated as cash flow hedges. The options hedged the market risk of a decline in value of AT&T Wireless securities. The market risk of a decline in these securities, below the respective put prices, had been eliminated. In addition, any market gains we may have earned had been limited to the call prices. These designated options were carried at fair value with changes in fair value recorded, net of income taxes, within "Accumulated other comprehensive loss" as a component of shareowners' equity. There was no ineffectiveness recognized on the cash flow hedges.

The shares of AT&T Wireless common stock were accounted for as "available-for-sale" securities under SFAS No. 115 with changes in the carrying value of the underlying securities that are not "other-than-temporary" being recorded as unrealized gains or losses, net of income taxes, within "Other comprehensive income (loss)" as a component of shareowners' equity. See note 7 for a discussion of impairments recorded in 2002.

Following is a summary of the exchangeable notes outstanding at December 31, 2002:

<u>Maturities</u>	<u>Face Value</u>	<u>Interest Rate</u>	<u>Put Price Per Share</u>	<u>Call Price Per Share</u>	<u>Carrying Value</u>
(Dollars in millions except per share amounts)					
Indexed to 45.8 million shares of AT&T Wireless common stock:					
2005	\$220	LIBOR + 0.4%	\$14.41	\$18.87	\$87
2006	220	LIBOR + 0.4%	14.41	19.31	87
2006	220	LIBOR + 0.4%	14.41	19.74	87
Indexed to 45 million shares of AT&T Wireless common stock:					
2006	\$204	LIBOR + 0.4%	\$13.57	\$19.03	\$85
2006	201	LIBOR + 0.4%	13.37	19.27	86
2006	204	LIBOR + 0.4%	13.57	19.90	87

In February 2003, AT&T redeemed these exchangeable notes that had a carrying value of \$652 million at the time of settlement. The notes were settled with 78.6 million shares of AT&T Wireless common stock and

AT&T CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

\$152 million in cash. The settlement resulted in a pretax gain of approximately \$176 million. The 12.2 million remaining AT&T Wireless shares were subsequently sold (see note 7).

9. Financial Instruments

In the normal course of business, we use various financial instruments, including derivative financial instruments, for purposes other than trading. These instruments include letters of credit, guarantees of debt and certain obligations of former affiliates, interest rate swap agreements, foreign currency exchange contracts, option contracts, equity contracts and warrants. Collateral is generally not required for these types of instruments. However, as the requirements for collateral are generally dependent upon debt ratings and market conditions, AT&T may be required to post collateral for interest rate and equity swaps, as well as letters of credit in the future.

By their nature, all such instruments involve risk, including the credit risk of nonperformance by counter-parties, and our maximum potential loss may exceed the amount recognized in our balance sheet. However, at December 31, 2002 and 2001, in management's opinion, there was no significant risk of loss in the event of nonperformance of the counter-parties to these financial instruments. We control our exposure to credit risk through credit approvals, credit limits and monitoring procedures. Other than the guarantee issued in connection with the split-off of AT&T Wireless, we do not have any significant exposure to any individual customer or counter-party, nor do we have any major concentration of credit risk related to any financial instruments.

Letters of Credit

Letters of credit are purchased guarantees that ensure our performance or payment to third parties in accordance with specified terms and conditions. Management has determined that the Company's letters of credit do not create additional risk to AT&T.

The notional amounts outstanding at December 31, 2002 and 2001, were \$923 million and \$408 million, respectively. The letters of credit in effect at December 31, 2002, were collateralized by restricted cash of \$496 million, of which \$442 million was recorded in "Other assets" and \$54 million was recorded in "Other current assets." The fair values of the letters of credit, based on the fees paid to obtain the obligations, were immaterial at December 31, 2002 and 2001.

Guarantees

From time to time, we guarantee the debt of our subsidiaries, and, in connection with the separation of certain subsidiaries, we issued guarantees for certain debt and other obligations of our former subsidiaries AT&T Capital Corp., NCR, AT&T Wireless and AT&T Broadband. We also issue indemnifications as part of our software license agreements.

Total notional amounts of guaranteed debt at December 31, 2002 and 2001, were \$506 million and \$59 million, respectively. Prior to the spin-off of AT&T Broadband, we had guaranteed certain debt of AT&T Broadband that matures in 2038. Such guarantee remained outstanding after the spin-off of AT&T Broadband and at December 31, 2002 totaled \$500 million. Comcast has provided us with an indemnification for this debt and, under the terms of the merger agreement between AT&T Broadband and Comcast, if Comcast does not call the debt in 2003 they must provide us with a letter of credit in the amount of \$500 million. The remaining guarantees for debt have expiration dates ranging from 2003 to 2020. Should the financial condition of debtors, including AT&T Broadband and Comcast, deteriorate to the point at which they are unable to meet their obligations, third party creditors could look to us for payment. We currently hold no collateral for these guarantees, and have not recorded corresponding obligations. At December 31, 2002 and 2001, there were no quoted market prices for similar agreements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

AT&T provides a guarantee of an obligation that AT&T Wireless has to NTT DoCoMo (DoCoMo). The amounts of the guarantee at December 31, 2002 and 2001, were \$4.1 billion and \$3.9 billion, respectively. On January 21, 2001, DoCoMo invested approximately \$9.8 billion for shares of AT&T preferred stock that were converted into AT&T Wireless common stock in connection with the split-off of AT&T Wireless. Of the initial investment, AT&T retained approximately \$3.6 billion, with the remainder of the proceeds allocated to AT&T Wireless. In connection with that investment, AT&T and AT&T Wireless agreed that, under certain circumstances, including if AT&T Wireless fails to meet specific technological milestones by June 30, 2004, DoCoMo would have the right to require AT&T Wireless to repurchase its AT&T Wireless common stock for \$9.8 billion, plus interest. In the event AT&T Wireless is unable to satisfy the entire obligation, AT&T is secondarily liable for up to \$3.65 billion, plus accrued interest. On December 26, 2002, AT&T Wireless and DoCoMo entered into an amendment to the original agreement which, among other things, extended the deadline for compliance with the technological milestones to December 31, 2004. We currently hold no collateral for this guarantee, and have not recorded a corresponding obligation. At December 31, 2002 and 2001, there were no quoted market prices for similar agreements.

The total notional amount of other guaranteed obligations at December 31, 2002, was \$458 million. Prior to the spin-off of AT&T Broadband, we had guaranteed various obligations of AT&T Broadband. In connection with the spin-off of AT&T Broadband, we continue to provide guarantees of these obligations, including operating leases for real estate, surety bonds, and equity hedges. These guarantees have expiration dates ranging from 2003 through 2007. Comcast has provided indemnifications for these guarantees of \$458 million at December 31, 2002. Should the financial condition of AT&T Broadband and Comcast deteriorate to the point at which they are unable to meet their obligations, third party creditors could look to us for payment. We currently hold no collateral for these guarantees, and have not recorded corresponding obligations. At December 31, 2002, there were no quoted market prices for similar agreements.

The total notional amounts of software license indemnifications with a stated maximum liability, at December 31, 2002 and 2001, were approximately \$50 million and \$30 million, respectively. In addition, in a few instances, our liability is limited by the value of the licensing fees received or is not limited at all. Amounts related to these indemnifications cannot be estimated. The indemnifications generally have terms that coincide with the software license which may be until terminated by the licensee. Under the terms of these agreements, we indemnify licensees against damages, expenses and losses arising from third party claims and proceedings against trademark, copyright and/or patent infringement. We currently hold no collateral for these guarantees and have not recorded corresponding obligations. At December 31, 2002, there were no quoted market prices for similar agreements.

Interest Rate Swap Agreements

We enter into interest rate swaps to manage our exposure to changes in interest rates. We enter into swap agreements to manage the fixed/floating mix of our debt portfolio in order to reduce aggregate risk to interest rate movements. Interest rate swaps also allow us to raise funds at floating rates and effectively swap them into fixed rates that are generally lower than those available to us if fixed-rate borrowings were made directly. These agreements involve the exchange of floating-rate for fixed-rate payments or the exchange of fixed-rate for floating-rate payments without the exchange of the underlying principal amount. Floating-rate payments are tied to the LIBOR. We also designated certain interest-rate swaps as cash flow hedges under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities."

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table indicates the types of swaps in use at December 31, 2002 and 2001, the respective notional amounts and their weighted-average interest rates. Average floating rates are those in effect at the reporting date, and may change significantly over the lives of the contracts:

	At December 31,	
	2002	2001
	(Dollars in millions)	
Floating-rate to fixed-rate swaps — notional amount	\$ 190	\$ 218
Weighted-average receive rate	1.81%	2.08%
Weighted-average pay rate	7.30%	7.31%

In addition, we have combined interest rate, foreign currency swap agreements for foreign-currency-denominated debt, which hedge our risk to both interest rate and currency movements. At December 31, 2002 and 2001, the notional amounts related to these contracts was \$3.8 billion, of which \$3.1 billion was associated with our Euro bond offering in 2001.

The table below summarizes the fair and carrying values of the agreements. These swaps are valued using current market quotes, which were obtained from dealers.

	2002		2001	
	Fair/Carrying Value		Fair/Carrying Value	
	Asset	Liability	Asset	Liability
	(Dollars in millions)			
Interest rate swap agreements	\$ —	\$23	\$—	\$18
Combined interest rate foreign currency swap agreements	660	—	18	26

Foreign Exchange

We enter into foreign currency forward contracts to manage our exposure to changes in currency exchange rates related to foreign-currency-denominated transactions. Although we do not designate most of our foreign exchange contracts as accounting hedges, we have certain contracts that are designated as foreign currency cash flow hedges in accordance with SFAS No. 133. At December 31, 2002, our foreign exchange contracts consisted principally of Euros, Japanese yen, and Swiss francs. At December 31, 2001, our foreign exchange contracts consisted principally of Canadian dollars (which related to our obligation to purchase the remaining shares of AT&T Canada), Euros, Japanese yen, Swiss francs, and Brazilian reais. In addition, we are subject to foreign exchange risk related to other foreign-currency-denominated transactions. The notional amounts under contract at December 31, 2002 and 2001, were \$742 million and \$6.4 billion, respectively. The decrease from 2001 was primarily due to approximately \$5.3 billion in 2001 of foreign exchange contracts relating to a Euro Commercial Paper Program and our obligation to purchase the outstanding AT&T Canada shares we did not own. A significant portion of our debt under the Euro Commercial Paper Program was paid down in 2002, and our obligation to purchase the outstanding shares of AT&T Canada was satisfied in 2002. The following table summarizes the fair and carrying values of the foreign exchange contracts at December 31, 2002 and 2001. These foreign exchange contracts are valued using current market quotes which were obtained from independent sources.

	2002		2001	
	Fair/Carrying Value		Fair/Carrying Value	
	Asset	Liability	Asset	Liability
	(Dollars in millions)			
Foreign exchange contracts	\$41	\$2	\$72	\$299

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Equity Option and Equity Swap Contracts

We enter into equity option and equity swap contracts, which are undesignated, to manage our exposure to changes in equity prices associated with various equity awards of previously affiliated companies (see note 12). The notional amounts outstanding on these contracts at December 31, 2002 and 2001, were \$112 million and \$19 million, respectively. The following table summarizes the carrying and fair values of these instruments at December 31, 2002 and 2001. Fair values are based on market quotes.

	2002		2001	
	Carrying/Fair Value		Carrying/Fair Value	
	Asset	Liability	Asset	Liability
	(Dollars in millions)			
Equity hedges	\$—	\$25	\$—	\$15

Warrants

We may obtain warrants to purchase equity securities in private and public companies as a result of certain transactions. Private warrants and public warrants that provide for net share settlement (i.e. allow for cashless exercise) are considered to be derivative instruments and recognized on our balance sheet at fair value (in accordance with SFAS No. 133). Warrants are not eligible to be designated as hedging instruments because there is no underlying exposure. Instead, these are effectively investments in private and public companies. The fair value of these warrants, as determined by using the Black-Scholes model, was \$2 million and \$24 million at December 31, 2002 and 2001, respectively.

Debt Securities

The carrying value of debt with an original maturity of less than one year approximates market value. The table below summarizes the carrying and fair values of long-term debt (including currently maturing long-term debt), excluding capital leases, at December 31, 2002 and 2001. The fair values of long-term debt were obtained based on quotes or rates available to us for debt with similar terms and maturities.

	2002		2001	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(Dollars in millions)			
Long-term debt, excluding capital leases . .	\$20,292	\$21,030	\$24,820	\$24,704

Derivative Impacts

The following table summarizes the activity in "Accumulated other comprehensive loss" in Shareowners' equity related to derivatives designated as cash flow hedges during the periods January 1, 2001 (date of the company's adoption of SFAS No. 133) through December 31, 2002. Unrealized amounts recorded within

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

"Accumulated other comprehensive loss" prior to adoption of SFAS No. 133 were recognized in earnings in conjunction with the adoption of SFAS No. 133 (\$1.6 billion pretax; \$1.0 billion after-tax), (see note 3).

	Pretax (Dollars in millions)	After-tax (Dollars in millions)
Balance at January 1, 2001	\$ —	\$ —
Unrealized gains (losses)	(480)	(296)
Realized (gains) losses reclassified into earnings	85	52
Balance at December 31, 2001	\$ (395)	\$ (244)
Unrealized gains (losses)	1,747	1,078
Realized (gains) losses reclassified into earnings	(1,259)	(777)
Net amounts spun-off with AT&T Broadband	317	196
Balance at December 31, 2002	<u>\$ 410</u>	<u>\$ 253</u>

Included within the balance at December 31, 2002, were unrealized gains of \$131 million pretax (\$81 million after-tax) on embedded derivatives related to exchangeable notes that were indexed to AT&T Wireless common stock, which were settled in February 2003. The remaining balance of unrealized gains at December 31, 2002, was largely offset within "Accumulated other comprehensive loss" by unrealized losses on the underlying debt. Based upon the expiration or maturity dates of these remaining derivatives designated as cash flow hedges, we do not expect additional amounts to be transferred into earnings within the next year.

10. Equity Transactions

Pursuant to the AT&T Broadband and Comcast merger agreement, AT&T was required to redeem the outstanding TCI Pacific Communications, Inc. Class A Senior Cumulative Exchangeable Preferred Stock for AT&T common stock. Each share of TCI Pacific preferred stock was exchangeable at the option of the holder for 8.365 shares (1.673 adjusted for the 1-for-5 reverse stock split) of AT&T common stock. All outstanding shares (approximately 6.2 million) of TCI Pacific preferred stock with a carrying value of \$2.1 billion at December 31, 2001 (included in Minority Interest of Discontinued Operations in the Consolidated Balance Sheet), were either exchanged or redeemed for approximately 51.8 million shares (10.4 million shares adjusted for the 1-for-5 reverse stock split) of AT&T common stock. No gain or loss was recorded on the exchange/redemption of the TCI Pacific preferred stock.

During 2002, AT&T issued 14.7 million shares (2.9 million shares adjusted for the 1-for-5 reverse stock split) of AT&T common stock to certain current and former senior managers in settlement of their deferred compensation accounts. Pursuant to AT&T's deferred compensation plan, senior managers may defer short- and long-term incentive compensation awards. The issuance of these shares resulted in an increase to total shareowners' equity of \$196 million.

In June 2002, AT&T completed a public equity offering of 230 million shares (46 million shares adjusted for the 1-for-5 reverse stock split) of AT&T common stock for net proceeds of \$2.5 billion. AT&T utilized the proceeds from the offering to satisfy a portion of its obligation to AT&T Canada common shareholders (see note 7).

On January 22, 2001, NTT DoCoMo invested approximately \$9.8 billion for 812,512 shares of a new class of AT&T preferred stock with a par value of \$1 per share. On July 9, 2001, in conjunction with the split-off of AT&T Wireless Group, these preferred shares were converted into AT&T Wireless common stock. During 2001, we recorded dividend requirements on this preferred stock of \$652 million. The preferred stock dividend represented interest in connection with the DoCoMo preferred stock as well as accretion of the

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

beneficial conversion feature associated with this preferred stock. The beneficial conversion feature was recorded upon the issuance of the preferred stock and represented the excess of the fair value of the preferred shares issued over the proceeds received.

11. Pension, Postretirement and Other Employee Benefit Plans

We sponsor noncontributory, defined benefit pension plans covering the majority of our employees. Pension benefits for management employees are based principally on career-average pay. Pension benefits for occupational employees are not directly related to pay. Pension trust contributions are made to trust funds held for the sole benefit of plan participants. Our benefit plans for current and certain future retirees include health-care benefits, life insurance coverage and telephone concessions.

The following table shows the components of the net periodic benefit (credit) costs for continuing operations included in our Consolidated Statements of Operations:

For the Years Ended December 31,	Pension Benefits			Postretirement Benefits		
	2002	2001	2000	2002	2001	2000
	(Dollars in millions)					
Service cost — benefits earned during the period	\$ 209	\$ 226	\$ 239	\$ 23	\$ 26	\$ 34
Interest cost on benefit obligations	1,002	938	983	365	344	351
Amortization of unrecognized prior service cost	152	172	174	12	4	4
Credit for expected return on plan assets	(1,526)	(1,647)	(1,812)	(187)	(201)	(230)
Amortization of transition asset	(34)	(89)	(156)	—	—	—
Amortization of (gains) losses	(22)	(182)	(332)	5	—	(16)
Charges for special termination (credits) benefits*	(19)	188	—	—	28	16
Net curtailment losses (gains)*	—	113	121	—	59	(14)
Net settlement losses*	<u>6</u>	<u>4</u>	<u>8</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net periodic benefit (credit) cost	<u>\$ (232)</u>	<u>\$ (277)</u>	<u>\$ (775)</u>	<u>\$ 218</u>	<u>\$ 260</u>	<u>\$ 145</u>

* Primarily included in "Net restructuring and other charges" in the Consolidated Statements of Operations.

In connection with our restructuring plan announced in the fourth quarter of 2001, we recorded a \$188 million charge related to management employee separation benefits expected to be funded by assets of the AT&T Management Pension Plan as well as a \$28 million charge related to expanded eligibility for postretirement benefits for certain employees expected to exit under the plan. We also recorded pension and postretirement benefit curtailment charges of \$172 million.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of assets, and a statement of the funded status:

<u>For the Years Ended December 31,</u>	<u>Pension Benefits</u>		<u>Postretirement Benefits</u>	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
	<u>(Dollars in millions)</u>			
Change in benefit obligations:				
Benefit obligation, beginning of year	\$13,878	\$12,898	\$ 5,277	\$ 4,851
Service cost	209	226	23	26
Interest cost	1,002	938	365	344
Plan amendments	34	62	14	—
Actuarial losses	1,134	655	640	373
Benefit payments	(1,221)	(1,072)	(480)	(406)
Special termination (credits) benefits	(19)	188	—	28
Settlements	(32)	(17)	—	—
Curtailment losses	—	—	—	61
Benefit obligation, end of year	<u>\$14,985</u>	<u>\$13,878</u>	<u>\$ 5,839</u>	<u>\$ 5,277</u>
Change in fair value of plan assets:				
Fair value of plan assets, beginning of year	\$18,449	\$21,055	\$ 2,156	\$ 2,521
Actual return on plan assets	(1,663)	(1,576)	(255)	(214)
Employer contributions	70	59	324	255
Benefit payments	(1,221)	(1,072)	(480)	(406)
Settlements	(32)	(17)	—	—
Fair value of plan assets, end of year	<u>\$15,603</u>	<u>\$18,449</u>	<u>\$ 1,745</u>	<u>\$ 2,156</u>
At December 31:				
Funded (unfunded) benefit obligation	\$ 618	\$ 4,571	\$ (4,094)	\$ (3,121)
Unrecognized net loss (gain)	1,715	(2,624)	1,684	606
Unrecognized transition asset	—	(34)	—	—
Unrecognized prior service cost (credits)	769	887	(10)	(12)
Net amount recorded	<u>\$ 3,102</u>	<u>\$ 2,800</u>	<u>\$ (2,420)</u>	<u>\$ (2,527)</u>

The AT&T Management Pension Plan had an unfunded accumulated benefit obligation of \$1.1 billion as of December 31, 2002. The accumulated benefit obligation of \$9.4 billion at December 31, 2002, was in excess of the fair value of the plan assets of \$8.3 billion. Our nonqualified pension plans had an unfunded accumulated benefit obligation of \$98 million and \$113 million at December 31, 2002 and 2001, respectively.

The unfunded accumulated benefit obligation for the AT&T Management Pension Plan is attributed primarily to the loss in value of the plan assets and the impact of the decline in the discount rate used to value the pension benefit obligations. As a result, due to the under-funded status of these plans, in 2002, the Company recorded an additional minimum pension liability of \$699 million. The offset to this liability was an intangible asset of \$410 million and a charge to "Other comprehensive income (loss)" of \$289 million (\$179 million, net of tax).

Our postretirement welfare benefit plans and telephone concession benefit plans had accumulated postretirement benefit obligations of \$5.9 billion at December 31, 2002, which was in excess of plan assets of

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

\$1.7 billion. Our postretirement welfare benefit plans and telephone concession benefit plans had accumulated postretirement benefit obligations of \$5.3 billion at December 31, 2001, which was in excess of plan assets of \$2.2 billion.

At December 31, 2002 and 2001, our pension plan assets included \$13 million and \$31 million of AT&T common stock, respectively.

The following table provides the amounts recorded in our Consolidated Balance Sheets:

At December 31,	Pension Benefits		Postretirement Benefits	
	2002	2001	2002	2001
	(Dollars in millions)			
Prepaid pension cost	\$ 3,596	\$3,329	\$ —	\$ —
Benefit related liabilities	(1,255)	(591)	(2,420)	(2,527)
Intangible asset (in "Other assets")	456	46	—	—
Accumulated other comprehensive income	305	16	—	—
Net amount recorded	<u>\$ 3,102</u>	<u>\$2,800</u>	<u>\$ (2,420)</u>	<u>\$ (2,527)</u>

The assumptions in the following table were used in the measurement of the pension and postretirement benefit obligations and the net periodic benefit costs, as applicable. These assumptions were reassessed as of December 31, 2002. The discount rate was reduced to 6.5% based on current yields on high quality corporate fixed-income investments with maturities corresponding to the expected duration of the benefit obligations. The expected long-term rate of return on plan assets was adjusted downward to 8.5% effective January 1, 2003, primarily in consideration of the current and projected investment portfolio mix and estimated long-term investment returns for each asset class. Additionally, the rate of projected compensation increases was reduced to 4.25% reflecting expected inflation levels, our actual recent experience and future outlook. Our previous years' disclosed compensation rates have been restated to include the component of the assumed compensation rate increase attributable to employee promotion.

At December 31,	Weighted-Average Assumptions		
	2002	2001	2000
Discount rate	6.50%	7.25%	7.50%
Expected return on plan assets	9.0%	9.5%	9.5%
Rate of compensation increase	4.25%	5.9%	5.9%

We assumed a rate of increase in the per capita cost of covered health-care benefits (the health-care cost trend rate) of 10.9%. This rate was assumed to gradually decline after 2002 to 5.0% by 2010 and then remain level. Assumed health-care cost trend rates have a significant effect on the amounts reported for the health-care plans. A one percentage point increase or decrease in the assumed health-care cost trend rate would increase or decrease the total of the service and interest-cost components of net periodic postretirement health-care benefit cost by \$11 million and \$10 million, respectively, and would increase or decrease the health-care component of the accumulated postretirement benefit obligation by \$175 million and \$152 million, respectively.

We also sponsor savings plans for the majority of our employees. The plans allow employees to contribute a portion of their pretax and/or after-tax income in accordance with specified guidelines. We match a percentage of the employee contributions up to certain limits. Contributions relating to continuing operations amounted to \$135 million in 2002, \$131 million in 2001, and \$206 million in 2000.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. Stock-Based Compensation Plans

Under the 1997 Long-term Incentive Program (Program), which was effective June 1, 1997, and amended on May 19, 1999, and March 14, 2000, we grant stock options, performance shares, restricted stock and other awards on AT&T common stock, and also granted stock options on AT&T Wireless Group tracking stock prior to the split-off of AT&T Wireless.

Under the initial terms of the Program, there were 30 million shares of AT&T common stock available for grant with a maximum of 4.5 million common shares that could be used for awards other than stock options. Subsequent to the 1999 modification, beginning with January 1, 2000, the remaining shares available for grant at December 31 of the prior year, plus 1.75% of the shares of AT&T common stock outstanding on January 1 of each year, become available for grant. Under the amended terms, a maximum of 7.5 million shares may be used for awards other than stock options. In 2001, as a result of the AT&T Wireless split-off, the number of shares available for grant increased by 3.5 million which includes 0.6 million for awards other than stock options. In 2002, AT&T restructured stock options and other stock-based awards in conjunction with the AT&T Broadband spin-off. The number of shares available for grant increased by 44.5 million which includes 0.8 million for awards other than stock options. The exercise price of any stock option is equal to the stock price when the option is granted. Generally, the options vest over three or four years and are exercisable up to 10 years from the date of grant. (All above share amounts have been adjusted for the 1-for-5 reverse stock split.)

Under the Program, performance share units are awarded to key employees in the form of either common stock or cash at the end of a three-year period, based on certain financial-performance targets.

On April 27, 2000, AT&T created a new class of stock and completed an offering of AT&T Wireless Group tracking stock. Under the Program, AT&T issued AT&T Wireless Group stock options to employees. The exercise price of any stock option was equal to the stock price when the option was granted. When granted, the options had a two to three and one-half year vesting period, and were exercisable up to 10 years from the date of grant. On April 27, 2000, substantially all employees were granted AT&T Wireless Group tracking stock options.

In connection with the July 9, 2001 split-off of AT&T Wireless Group, all outstanding AT&T Wireless Group tracking stock options and all AT&T common stock options granted prior to January 1, 2001, were converted in the same manner as common shares (see note 1). AT&T modified the terms and conditions of all outstanding stock option grants to allow the AT&T Wireless common stock options held by AT&T employees to immediately vest and become exercisable for their remaining contractual term and to also allow the AT&T common stock options held by AT&T Wireless employees to immediately vest and become exercisable for their remaining contractual term. In 2001, AT&T recognized \$3 million of compensation expense related to these modifications.

In connection with the spin-off of AT&T Broadband, all outstanding AT&T stock options held by active AT&T employees were restructured into an adjusted number of AT&T options. All outstanding AT&T stock options held by active AT&T Broadband employees were restructured into an adjusted number of AT&T Broadband options and subsequently replaced with new Comcast stock options, and all AT&T stock options held by inactive employees at the time of the spin-off were converted into adjusted AT&T stock options and new Comcast stock options. In January 2002, AT&T modified the terms and conditions of outstanding AT&T stock options and other equity awards granted under plans other than the Program and held by AT&T Broadband employees. This modification provided that upon the change in control of AT&T Broadband, their stock options and other equity awards granted prior to December 19, 2001, would be immediately vested and exercisable through their remaining contractual term. In 2002, \$48 million (pretax) of compensation expense related to this modification was recognized by AT&T Broadband and is included within "Gain on disposition of discontinued operations."

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Under the AT&T 1996 Employee Stock Purchase Plan (Plan), which was effective July 1, 1996, and amended on May 23, 2001, we are authorized to sell up to 21 million shares of AT&T common stock to our eligible employees through June 30, 2006. Under the terms of the Plan, employees may have up to 10% of their earnings withheld to purchase AT&T's common stock. The purchase price of the stock on the date of exercise is 85% of the average high and low sale prices of shares on the New York Stock Exchange for that day. Under the Plan, we sold approximately 1.3 million, 1.2 million and 1.1 million shares to employees in 2002, 2001 and 2000, respectively. (All above share amounts have been adjusted for the 1-for-5 reverse stock split.)

A summary of the AT&T common stock option transactions is shown below. (All share and per share amounts have been restated to reflect the 1-for-5 reverse stock split.)

	2002	Weighted-Average Exercise Price*	2001	Weighted-Average Exercise Price*	2000	Weighted-Average Exercise Price*
			(Shares in thousands)			
Outstanding at January 1,	63,509	\$122.90	49,805	\$179.10	33,753	\$187.10
Options assumed in mergers					5,923	123.55
Options granted	15,183	68.84	13,680	110.85	14,914	180.60
AT&T Wireless split-off adjustments . . .			4,330			
AT&T Broadband spin-off adjustments . .	37,049					
Options and SARs exercised	(436)	32.28	(1,044)	58.15	(2,290)	110.35
Options canceled or forfeited	(17,048)	125.72	(3,262)	155.35	(2,495)	228.05
At December 31:						
Options outstanding	98,257	40.64	63,509	122.90	49,805	179.10
Options exercisable	46,770	49.88	34,289	130.25	26,290	152.20
Shares available for grant	27,751		6,944		6,841	

* The weighted-average exercise prices for the period prior to the AT&T Wireless split-off in 2001, and for the year ended December 31, 2000, have not been adjusted to reflect the impact of the split-off. The weighted-average exercise prices for the period prior to the AT&T Broadband spin-off in 2002, and for the years ended December 31, 2001 and 2000, have not been adjusted to reflect the impact of the spin-off.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes information about the AT&T common stock options outstanding at December 31, 2002:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at December 31, 2002 (In thousands)	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at December 31, 2002 (In thousands)	Weighted-Average Exercise Price
\$ 3.93 – \$23.70	3,368	5.6	\$16.76	2,316	\$14.57
\$23.88	10,417	9.7	\$23.88	8	\$23.88
\$23.94 – \$28.00	1,166	8.5	\$25.75	406	\$25.59
\$28.03	21,465	9.1	\$28.03	422	\$28.03
\$28.23 – \$33.66	9,148	8.2	\$32.15	3,716	\$32.04
\$33.68	8,341	8.2	\$33.68	2,823	\$33.68
\$33.77 – \$38.27	8,206	4.6	\$35.68	7,172	\$35.68
\$38.31	3,657	4.1	\$38.31	3,657	\$38.31
\$38.48 – \$46.73	4,050	4.6	\$44.35	3,459	\$44.21
\$46.91	5,553	7.6	\$46.91	3,113	\$46.91
\$47.04 – \$61.54	8,609	5.5	\$59.06	8,506	\$59.15
\$61.66 – \$87.01	9,136	6.9	\$71.10	7,146	\$71.71
\$87.51 – \$90.80	<u>5,141</u>	6.1	\$87.52	<u>4,026</u>	\$87.52
	<u>98,257</u>	7.4	\$40.64	<u>46,770</u>	\$49.88

A summary of the AT&T Wireless Group tracking stock option transactions is shown below:

	2001	Weighted-Average Exercise Price	2000	Weighted-Average Exercise Price
		(Shares in thousands)		
Outstanding at January 1:	73,626	\$29.29	—	\$ —
Options granted	4,037	\$22.57	76,983	\$29.29
Options exercised	(1)	\$22.03	—	\$ —
Options canceled or forfeited	(2,711)	\$29.11	(3,357)	\$29.43
Options assumed by AT&T Wireless on July 9th	(74,951)			
At December 31:				
Options outstanding	—	\$ —	73,626	\$29.29
Options exercisable	—	\$ —	12,391	\$29.48
Shares available for grant	—		41,874	

In 2002, AT&T offered employees the option to cancel certain outstanding stock option grants and replace them with restricted stock units. Approximately 15 million stock options were canceled as a result of this offer, and 2.5 million restricted stock units were granted which vest over a three-year period. The 2.5 million restricted stock units were restructured into 6.5 million units as a result of the spin-off of AT&T Broadband. Those options that were eligible for cancellation but retained by the employee became variable awards and will be marked to market until the options are exercised, forfeited, or expired unexercised. The cancellation of stock options had an immaterial impact on 2002 results of operations.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The weighted-average fair values at date of grant for AT&T common stock options granted during 2002, 2001 and 2000 were \$24.49, \$39.50 and \$60.50, respectively, and were estimated using the Black-Scholes option-pricing model. The weighted-average risk-free interest rates applied for 2002, 2001 and 2000 were 3.73%, 4.61% and 6.29%, respectively. The following assumptions were applied for 2002, 2001 and 2000, respectively: (i) expected dividend yields of 1.17%, 0.85% and 1.6%, (ii) expected volatility rates of 40.0%, 36.9% and 33.5% and (iii) expected lives of 4.7 years in 2002, 2001 and 2000.

The weighted-average fair values at date of grant for AT&T Wireless Group tracking stock options granted during 2001 and 2000 were \$11.58 and \$14.20, respectively, and were estimated using the Black-Scholes option-pricing model. The following weighted-average assumptions were applied for 2001 and 2000, respectively: (i) risk-free rate of 4.92% and 6.53%, (ii) expected volatility rate of 55.0% in 2001 and 2000 and (iii) expected lives of 4.8 years and 3.9 years.

Effective January 1, 2003, AT&T will begin recording compensation expense pursuant to SFAS No. 123, "Accounting for Stock Based Compensation," for AT&T common stock options issued subsequent to January 1, 2003. The fair value of these stock options will be measured on the grant date and recognized in the income statement over the vesting period. (For additional information, see note 2.)

13. Income Taxes

The following table shows the principal reasons for the difference between the effective income tax rate and the U.S. federal statutory income tax rate:

	For the Years Ended December 31,		
	2002	2001	2000
	(Dollars in millions)		
U.S. federal statutory income tax rate	35%	35%	35%
Federal income tax (provision) at statutory rate	\$ (993)	\$ (2,683)	\$ (4,368)
Amortization of investment tax credits	16	18	23
State and local income tax (provision), net of federal income tax effect	(222)	(209)	(292)
AT&T Latin America charge	(360)	—	—
Foreign operations, net of tax credits	(140)	(107)	(20)
Investment dispositions, acquisitions and legal entity restructurings	93	91	70
Research and other credits	51	42	36
Other differences, net	(32)	(42)	64
(Provision) for income taxes	<u>\$ (1,587)</u>	<u>\$ (2,890)</u>	<u>\$ (4,487)</u>
Effective income tax rate	56.0%	37.7%	35.9%

AT&T CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The U.S. and foreign components of income from continuing operations before income taxes and the (provision) for income taxes are presented in the following table:

	For the Years Ended December 31,		
	2002	2001	2000
	(Dollars in millions)		
Income From Continuing Operations Before Income Taxes			
United States	\$ 2,924	\$ 7,671	\$12,727
Foreign	(88)	(5)	(247)
Total	<u>\$ 2,836</u>	<u>\$ 7,666</u>	<u>\$12,480</u>
(Provision) For Income Taxes			
Current:			
Federal	\$ 1,041	\$ (1,554)	(3,126)
State and local	19	(192)	(416)
Foreign	(95)	(98)	(87)
	<u>965</u>	<u>(1,844)</u>	<u>(3,629)</u>
Deferred:			
Federal	(2,201)	(936)	(851)
State and local	(360)	(129)	(34)
Foreign	(7)	1	4
	<u>(2,568)</u>	<u>(1,064)</u>	<u>(881)</u>
Deferred investment tax credits	<u>16</u>	<u>18</u>	<u>23</u>
(Provision) for income taxes	<u>\$ (1,587)</u>	<u>\$ (2,890)</u>	<u>\$ (4,487)</u>

We also recorded current and deferred income tax benefits that resulted from net losses (earnings) related to other equity investments in the amounts of \$112 million in 2002, \$2.9 billion in 2001, and \$59 million in 2000.

Deferred income tax liabilities are taxes we expect to pay in future periods. Similarly, deferred income tax assets are recorded for expected reductions in taxes payable in future periods. Deferred income taxes arise because of differences in the book and tax basis of certain assets and liabilities.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Deferred income tax liabilities and assets consist of the following:

	At December 31,	
	2002	2001
	(Dollars in millions)	
Deferred Income Tax Assets		
Reserves and allowances	\$ 845	\$2,237
Employee pensions and other benefits	604	843
Business restructuring	297	359
Investments	281	423
Net operating loss, capital loss and credit carryforwards	252	70
Advance payments	174	30
Other deferred tax assets	162	419
Valuation allowance	(689)	(34)
Total deferred income tax assets	<u>1,926</u>	<u>4,347</u>
Deferred Income Tax Liabilities		
Property, plant and equipment	3,135	3,230
Leveraged and capital leases	1,059	1,078
Capitalized software and intangible assets	743	575
Other	818	710
Total deferred income tax liabilities	<u>5,755</u>	<u>5,593</u>
Net deferred income tax liability	<u>\$3,829</u>	<u>\$1,246</u>

The net increase in the valuation allowance in 2002 of \$655 million was primarily attributable to the book and tax basis difference relating to our investment in AT&T Latin America.

At December 31, 2002, the tax effect of net operating and capital loss carryforwards for federal and state income tax purposes were \$10 million and \$130 million, respectively, which expire through 2021. In addition, at December 31, 2002, federal tax credit carryforwards were \$1 million, with no expiration date, and state tax credit carry-forwards were \$111 million expiring through 2016.

14. Commitments and Contingencies

In the normal course of business we are subject to proceedings, lawsuits and other claims, including proceedings under laws and regulations related to environmental and other matters. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance.

In connection with the separation of its former subsidiaries, AT&T has entered into a number of separation and distribution agreements that provide, among other things, for the allocation and/or sharing of certain costs associated with potential litigation liabilities. For example, pursuant to these agreements, AT&T shares in the cost of certain litigation (relating to matters while affiliated with AT&T) if the settlement exceeds certain thresholds. With the exception of the Sparks matter (see note 1), as of December 31, 2002, we have assessed that none of the litigation liabilities allocated to former subsidiaries were probable of incurring costs in excess of the threshold above which we would be required to share in the costs. However, in the event these former subsidiaries were unable to meet their obligations with respect to these liabilities due to financial difficulties, AT&T could be held responsible for all or a portion of the costs, irrespective of the sharing agreements.

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Consequently, we are unable to ascertain the ultimate aggregate amount of monetary liability or financial impact with respect to these matters at December 31, 2002. However, we believe that after final disposition, any monetary liability or financial impact to us beyond that provided for at year-end would not be material to our annual consolidated financial statements.

Leases and Other Commitments

From time to time, AT&T provides guarantees of debt or other obligations relating to former subsidiaries. (Guarantees are occasionally provided for subsidiaries when owned by AT&T or in connection with its separation from AT&T. See note 9 for a detailed discussion of these guarantees.)

We lease land, buildings and equipment through contracts that expire in various years through 2040. Our rental expense under operating leases was \$529 million in 2002, \$552 million in 2001 and \$583 million in 2000. The total of minimum rentals to be received in the future under non-cancelable operating subleases as of December 31, 2002, was \$250 million.

The following table shows our future minimum commitments due under non-cancelable operating and capital leases at December 31, 2002:

	Operating Leases	Capital Leases
	(Dollars in millions)	
2003	\$ 480	\$ 10
2004	409	19
2005	320	8
2006	252	8
2007	203	8
Later years	460	100
Total minimum lease payments	<u>\$2,124</u>	153
Less: Amount representing interest		<u>52</u>
Present value of net minimum lease payments		<u>\$101</u>

In addition, under certain real estate operating leases, we could be required to make payments to the lessor of up to \$447 million at the end of the lease term (ending in years 2004 through 2007). The actual amount paid, if any, would be reduced by amounts received by the lessor upon remarketing of the property. (See note 18 for a discussion of the possible consolidation of certain of entities that we lease facilities from.)

AT&T has contractual obligations to utilize network facilities from local exchange carriers with terms greater than one year. Since the contracts have no minimum volume requirement and are based on an interrelationship of volumes and discounted rates, we assessed our minimum exposure based on penalties to exit the contracts on December 31 of each year. At December 31, 2002, the penalties AT&T would incur if we exited all of these contracts would be \$2.1 billion.

15. Segment Reporting

AT&T's results are segmented according to the customers we service: AT&T Business Services and AT&T Consumer Services.

AT&T Business Services provides a variety of services to various sized businesses and government agencies including long distance, international, toll-free and local voice, data and Internet protocol (IP) services; managed services; and wholesale transport services.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

AT&T Consumer Services provides a variety of communications services to residential customers, including domestic and international long distance, transaction-based long distance, such as operator-assisted service and prepaid phone cards; local and local toll (intrastate calls outside the immediate local area); and dial-up Internet.

The balance of AT&T's continuing operations (excluding LMG) is included in a "Corporate and Other" group. This group primarily reflects corporate staff functions and the elimination of transactions between segments. LMG was not an operating segment of AT&T prior to its split-off from AT&T because AT&T did not have a controlling financial interest in LMG for financial accounting purposes. Therefore, we accounted for this investment under the equity method. Additionally, LMG's results were not reviewed by the chief operating decision-makers for purposes of determining resources to be allocated.

Total assets for our reportable segments include all assets, except intercompany receivables. AT&T prepaid pension assets and corporate-owned or leased real estate are held at the corporate level and therefore are included in the Corporate and Other group. In addition, as the assets of discontinued operations are not considered to be a part of AT&T's ongoing operations, they are included in a category separate from reportable segments and the Corporate and Other group for reporting purposes. Capital additions for each segment include capital expenditures for property, plant and equipment, additions to nonconsolidated investments, and additions to internal-use software (which are included in "Other assets").

The accounting policies of the segments are the same as those described in the summary of significant accounting policies (see note 2). AT&T evaluates performance based on several factors, of which the primary financial measure is earnings before interest and taxes, including pretax minority interest and net pretax losses from other equity investments (EBIT).

Generally, AT&T accounts for inter-segment transactions at market prices. AT&T Business Services sells services to AT&T Consumer Services at cost-based prices, which approximate market prices. Generally AT&T Business Services accounts for these sales as contra-expense.

<i>Revenue</i>	For the Years Ended December 31,		
	2002	2001	2000
	(Dollars in millions)		
AT&T Business Services external revenue.....	\$26,235	\$27,264	\$28,136
AT&T Business Services internal revenue	323	441	423
Total AT&T Business Services revenue	26,558	27,705	28,559
AT&T Consumer Services external revenue	11,527	14,843	18,643
Total reportable segments	38,085	42,548	47,202
Corporate and Other.....	(258)	(351)	(352)
Total revenue.....	<u>\$37,827</u>	<u>\$42,197</u>	<u>\$46,850</u>
<i>Depreciation and Amortization</i>	For the Years Ended December 31,		
	2002	2001	2000
	(Dollars in millions)		
AT&T Business Services	\$4,546	\$4,234	\$4,255
AT&T Consumer Services	230	200	167
Total reportable segments	4,776	4,434	4,422
Corporate and Other.....	112	125	116
Total depreciation and amortization	<u>\$4,888</u>	<u>\$4,559</u>	<u>\$4,538</u>

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<i>Net (Losses) Earnings Related to Other Equity Investments</i>	For the Years Ended December 31,		
	2002	2001	2000
	(Dollars in millions)		
AT&T Business Services pretax net (losses)	\$(454)	\$(6,482)	\$ (8)
Corporate and Other pretax net (losses)	(58)	(1,301)	(43)
Total pretax (losses)	(512)	(7,783)	(51)
Total tax benefit	112	2,947	61
Total net (losses) earnings related to other equity investments	<u>\$(400)</u>	<u>\$(4,836)</u>	<u>\$ 10</u>

Reconciliation of EBIT to Income from Continuing Operations Before Income Taxes, Minority Interest Income and Losses Related to Other Equity Investments

	For the Years Ended December 31,		
	2002	2001	2000
	(Dollars in millions)		
AT&T Business Services EBIT	\$ 1,638	\$(2,305)	\$ 5,917
AT&T Consumer Services EBIT	2,647	4,875	6,893
Total reportable segments EBIT	4,285	2,570	12,810
Corporate and Other EBIT	(399)	(1,063)	1,163
Total EBIT	3,886	1,507	13,973
Deduct:			
Minority interest income	114	131	41
Pretax net (losses) related to other equity investments ...	(512)	(7,783)	(51)
Add: Interest (expense)	(1,448)	(1,493)	(1,503)
Income from continuing operations before income taxes, minority interest income and losses related to other equity investments	<u>\$ 2,836</u>	<u>\$ 7,666</u>	<u>\$12,480</u>

Assets

	At December 31,	
	2002	2001
	(Dollars in millions)	
AT&T Business Services	\$36,365	\$ 40,316
AT&T Consumer Services	1,674	2,141
Total reportable segments	38,039	42,457
Corporate and Other assets ⁽¹⁾	17,233	19,872
Total assets from discontinued operations	—	103,152
Total Assets	<u>\$55,272</u>	<u>\$165,481</u>

⁽¹⁾ Includes cash of \$7.8 billion for 2002 and \$10.4 billion for 2001

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<i>Capital Additions</i>	For the Years Ended December 31,		
	2002	2001	2000
	(Dollars in millions)		
AT&T Business Services	\$3,716	\$5,451	\$6,841
AT&T Consumer Services	127	140	148
Total reportable segments	3,843	5,591	6,989
Corporate and Other	63	150	1,594
Total capital additions	<u>\$3,906</u>	<u>\$5,741</u>	<u>\$8,583</u>

Geographic information is not presented due to the immateriality of revenue attributable to international customers.

Reflecting the dynamics of our business, we continually review our management model and structure, which may result in additional adjustment to our operating segments in the future.

16. Related Party Transactions

AT&T had various related party transactions with Concert until the joint venture was officially unwound on April 1, 2002.

Included in "Revenue" was \$268 million, \$1.1 billion and \$1.1 billion for services provided to Concert for the years ended December 31, 2002, 2001 and 2000, respectively.

Included in "Access and other connection" are charges from Concert representing costs incurred on our behalf to connect calls made to foreign countries (international settlements) and costs paid by AT&T to Concert for distributing Concert products totaling \$491 million, \$2.1 billion and \$2.4 billion for the years ended December 31, 2002, 2001 and 2000, respectively.

The Consolidated Balance Sheet at December 31, 2001, included a loan of \$1.0 billion to Concert, which was included within "Other assets." Interest income of \$67 million was recognized for the year ended December 31, 2000. In the third quarter of 2001, this loan together with the associated accrued interest was written off in connection with the decision to unwind Concert (see note 7).

At December 31, 2001, AT&T had a floating-rate loan payable to Concert in the amount of \$80 million. The loan was included in "Debt maturing within one year" at December 31, 2001. This loan was paid off in conjunction with the unwind of Concert. Interest expense was \$5 million and \$6 million for the years ended December 31, 2001 and 2000, respectively.

Included in "Accounts receivable" at December 31, 2001, was \$438 million related to telecommunications transactions with Concert. Included in "Accounts payable" at December 31, 2001, was \$201 million related to transactions with Concert.

Included in "Other receivables" at December 31, 2001, was \$781 million related to administrative transactions performed on behalf of Concert. Included in "Other current liabilities" at December 31, 2001, was \$935 million related to administrative transactions performed by Concert on behalf of AT&T.

We had various related party transactions with LMG. Included in "Costs of services and products" were programming expenses related to services from LMG. These expenses amounted to \$199 million for the seven months ended July 31, 2001, the effective split-off date of LMG for accounting purposes, and \$239 million for the year ended December 31, 2000.

AT&T CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

17. Quarterly Information (Unaudited)

2002	First	Second ⁽¹⁾	Third	Fourth ⁽²⁾
	(Dollars in millions, except per share amounts)			
Revenue	\$ 9,548	\$ 9,580	\$ 9,409	\$ 9,290
Operating income (loss)	1,634	1,592	1,415	(280)
Income (loss) from continuing operations	446	603	525	(611)
Net (loss) from discontinued operations (net of income taxes)	(565)	(13,433)	(318)	(197)
Gain on disposition of discontinued operations (net of income taxes)	—	—	—	1,324
(Loss) income before cumulative effect of accounting change	(119)	(12,830)	207	516
Cumulative effect of accounting change (net of income taxes)	(856)	—	—	—
Net (loss) income	(975)	(12,830)	207	516
AT&T Common Stock Group: ⁽³⁾				
Earnings (loss) per share — basic:				
Earnings (loss) from continuing operations	\$ 0.63	\$ 0.83	\$ 0.68	\$ (0.79)
(Loss) from discontinued operations	(0.80)	(18.41)	(0.41)	(0.26)
Gain on disposition of discontinued operations	—	—	—	1.71
Cumulative effect of accounting change	(1.21)	—	—	—
AT&T Common Stock Group (loss) earnings	\$ (1.38)	\$ (17.58)	\$ 0.27	\$ 0.66
Earnings (loss) per share — diluted:				
Earnings (loss) from continuing operations	\$ 0.60	\$ 0.80	\$ 0.67	\$ (0.79)
(Loss) from discontinued operations	(0.76)	(17.91)	(0.41)	(0.26)
Gain on disposition of discontinued operations	—	—	—	1.71
Cumulative effect of accounting change	(1.16)	—	—	—
AT&T Common Stock Group (loss) earnings	\$ (1.32)	\$ (17.11)	\$ 0.26	\$ 0.66
Dividends declared	0.1875	0.1875	0.1875	0.1875
AT&T common stock				
High	\$ 39.47	\$ 32.50	\$ 26.35	\$ 29.42
Low	27.62	18.64	16.81	21.43
Quarter-end close	32.19	21.94	24.62	26.11

AT&T CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2001	First	Second	Third ⁽⁴⁾	Fourth
	(Dollars in	millions, except	per share	amounts)
Revenue	\$10,890	\$10,602	\$10,537	\$10,168
Operating income	2,451	2,265	2,313	803
Income (loss) from continuing operations	556	(1,433)	(1,547)	(216)
Net (loss) from discontinued operations (net of income taxes)	(1,804)	(525)	(548)	(1,175)
Gain on disposition of discontinued operations (net of income taxes)	—	—	13,503	—
Net (loss) income before cumulative effect of accounting change	(1,248)	(1,958)	11,408	(1,391)
Cumulative effect of accounting change (net of income taxes)	904	—	—	—
Net (loss) income ⁽⁵⁾	(344)	(1,958)	11,408	(1,391)
AT&T Common Stock Group: ⁽³⁾				
Earnings (loss) per share — basic:				
Earnings (loss) from continuing operations	\$ 1.41	\$ 0.51	\$ (2.68)	\$ (0.31)
(Loss) from discontinued operations	(2.36)	(0.77)	(0.77)	(1.66)
Gain on disposition of discontinued operations	—	—	19.10	—
Cumulative effect of accounting change	0.47	—	—	—
AT&T Common Stock Group (loss) earnings	\$ (0.48)	\$ (0.26)	\$ 15.65	\$ (1.97)
Earnings (loss) per share — diluted:				
Earnings (loss) from continuing operations	\$ 1.32	\$ 0.48	\$ (2.68)	\$ (0.31)
(Loss) from discontinued operations	(2.21)	(0.72)	(0.77)	(1.66)
Gain on disposition of discontinued operations	—	—	19.10	—
Cumulative effect of accounting change	0.44	—	—	—
AT&T Common Stock Group (loss) earnings	\$ (0.45)	\$ (0.24)	\$ 15.65	\$ (1.97)
Dividends declared	0.1875	0.1875	0.1875	0.1875
AT&T Wireless Group (loss) earnings from discontinued operations per basic and diluted share ^{(3),(6)}	\$ (0.02)	\$ 0.08	—	—
Liberty Media Group (loss) earnings per basic and diluted share ⁽⁷⁾	\$ (0.06)	\$ (0.82)	\$ 0.04	—
Stock price ⁽⁸⁾				
AT&T common stock				
High	\$ 40.00	\$ 37.05	\$ 44.00	\$ 41.01
Low	27.67	31.56	33.85	30.24
Quarter-end close	33.92	35.03	39.57	37.19
AT&T Wireless Group common stock ⁽⁶⁾				
High	\$ 27.30	\$ 21.10	\$ 19.92	—
Low	17.06	15.29	12.52	—
Quarter-end close	19.18	16.35	—	—
Liberty Media Group Class A common stock ⁽⁷⁾				
High	\$ 17.25	\$ 18.04	\$ 17.85	—
Low	11.88	11.50	14.50	—
Quarter-end close	14.00	17.49	—	—

AT&T CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2001	First	Second	Third ⁽⁴⁾	Fourth
	(Dollars in	millions, except	per share	amounts
Liberty Media Group Class B common stock ⁽⁷⁾				
High	\$ 18.69	\$ 18.75	\$ 18.35	—
Low	14.20	12.50	12.00	—
Quarter-end close	15.00	18.15	—	—

⁽¹⁾ The loss from discontinued operations in the second quarter of 2002 included impairment charges of \$16.5 billion (\$11.8 billion after-tax) of goodwill and franchise costs.

⁽²⁾ Fourth quarter 2002 net income included \$1,463 of net restructuring and other charges.

⁽³⁾ Earnings per share (EPS) in each quarter is computed using the weighted-average number of shares outstanding during the quarter while EPS for the full year is computed using the weighted-average number of shares outstanding during the year. Thus, the sum of the four quarters' EPS does not always equal the full-year EPS.

⁽⁴⁾ Third quarter 2001 net income included a gain on disposition of discontinued operations of \$13,503, or \$19.10 per share.

⁽⁵⁾ First quarter 2001 net income included cumulative effect of accounting change of \$359 and \$545, or \$0.44 per diluted share and \$0.21 per share, for AT&T Common Stock Group and LMG, respectively, due to the adoption of SFAS No. 133.

⁽⁶⁾ No dividends had been declared on AT&T Wireless Group common stock. AT&T Wireless Group was split-off from AT&T on July 9, 2001.

⁽⁷⁾ No dividend had been declared on LMG common stock. LMG was split-off from AT&T on August 10, 2001.

⁽⁸⁾ Stock prices obtained from the New York Stock Exchange Composite Tape. AT&T Common Stock prices have been restated to reflect the spin-off of AT&T Broadband and for the 1-for-5 reverse stock split.

18. Variable Interest Entities

As stated in note 19, AT&T is currently assessing the potential impacts of FASB Interpretation No. 46, "Consolidation of Variable Interest Entities." As part of that assessment, we have determined that one entity, from which we currently lease two buildings, may be determined to be a Variable Interest Entity and subject to consolidation. We have no ownership interest in this entity and our transactions with it have met the requirements to be classified as operating leases, with AT&T being the lessee. At the end of their respective lease terms (including any extensions), AT&T has the option to: renew the lease for a new term, purchase the property at the unamortized loan funding amount, or exercise the remarketing option. Under the remarketing option, AT&T could be held liable for a loss in value relative to the properties. At December 31, 2002, our maximum exposure was \$99 million. This entity has approximately \$105 million of total assets, (principally the leased properties) and \$110 million of liabilities (principally long term debt secured by the properties).

In addition, we have six leases with another entity, having characteristics similar to those described above. It is possible that this entity may be deemed to be a VIE. We may, therefore, have variable interests in specified assets of this entity and be subject to "silo" consolidation of the specific assets and related liabilities. At December 31, 2002, our maximum total exposure related to this entity was \$328 million. The estimated building value is approximately \$362 million and the outstanding long-term debt is approximately \$386 million.

19. New Accounting Pronouncements

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." This standard requires that obligations that are legally enforceable and unavoidable, and are associated with the retirement of tangible long-lived assets, be recorded as liabilities when those obligations are incurred, with the amount of the liability initially measured at fair value. The offset to the initial asset retirement obligation is an increase in the carrying amount of the related long-lived asset. Over time, this liability is accreted to its future value, and the asset is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. SFAS

AT&T CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

No. 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. For AT&T, this means that the standard was adopted on January 1, 2003. AT&T currently includes in its group depreciation rates an amount related to the cost of removal for certain assets. However, such amounts are not legally enforceable or unavoidable; therefore, AT&T will be required to reverse the amount accrued in accumulated depreciation. As of January 1, 2003, AT&T will report approximately \$40 million as the cumulative effect of a change in accounting principles related to this reversal. The impact of no longer including the cost of removal in the group depreciation rates, coupled with the cumulative effect impact on accumulated depreciation, will result in a decrease to depreciation expense in 2003. However, the costs incurred to remove these assets will be reflected as a cost in the period incurred as "Costs of services and products."

On June 28, 2002, the FASB issued SFAS No. 146, "Accounting for Exit or Disposal Activities." This statement addresses the recognition, measurement and reporting of costs that are associated with exit and disposal activities. This statement includes the restructuring activities that are currently accounted for pursuant to the guidance set forth in EITF 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)," costs related to terminating a contract that is not a capital lease and one-time benefit arrangements received by employees who are involuntarily terminated - nullifying the guidance under EITF 94-3. Under SFAS No. 146 the cost associated with an exit or disposal activity is recognized in the periods in which it is incurred rather than at the date the company committed to the exit plan. This statement is effective for exit or disposal activities initiated after December 31, 2002, with earlier application encouraged. Previously issued financial statements will not be restated. The provisions of EITF 94-3 shall continue to apply for exit plans initiated prior to the adoption of SFAS No. 146. Accordingly, the initial adoption of SFAS No. 146 will not have an effect on AT&T's results of operations, financial position or cash flows. Liabilities associated with future exit and disposal activities will not be recognized until actually incurred.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure — an amendment of FASB Statement No. 123." This standard provides alternate methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation and requires more prominent disclosure about the method used. This statement is effective for fiscal years ending after December 15, 2002. For AT&T, this means it is effective for December 31, 2002. Currently AT&T applies the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" and we do not expense our stock options. However, as previously announced, AT&T will begin expensing all stock options issued after January 1, 2003, and will continue to apply the disclosure-only provisions to stock options issued prior to January 1, 2003. This method of transition is in compliance with the provisions of SFAS No. 148. The adoption of the disclosure provisions of SFAS No. 148 will not have an impact on AT&T's results of operations, financial position or cash flows; however, the expensing of the stock options issued after January 1, 2003, will have a negative impact on our results of operations.

In November 2002, the FASB issued FASB Interpretation No. (FIN) 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN 45 requires that an entity issuing a guarantee (including those embedded in a purchase or sales agreement) must recognize, at the inception of the guarantee, a liability equal to the fair value of the guarantee. FIN 45 also requires detailed information about each guarantee or group of guarantees even if the likelihood of making a payment is remote. The disclosure requirements of this interpretation are effective for financial statements of periods ending after December 15, 2002, which makes them effective for AT&T for December 31, 2002 (see note 9 for the disclosures required under this interpretation). The recognition and measurement provisions of this Interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. FIN 45 could have an impact on the future results of AT&T depending on guarantees issued; however, at this time we do not believe that the adoption of this statement will have a material impact on our results of operation, financial position or cash flows.

AT&T CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In January 2003, the FASB issued FIN 46, "Consolidation of Variable Interest Entities — an Interpretation of Accounting Research Bulletin (ARB) No. 51." FIN 46 requires the primary beneficiary to consolidate a variable interest entity (VIE) if it has a variable interest that will absorb a majority of the entity's expected losses if they occur, receive a majority of the entity's expected residual returns if they occur, or both. FIN 46 applies immediately to VIEs created after January 31, 2003, and to VIEs in which the entity obtains an interest after that date. For VIEs acquired before February 1, 2003, the effective date for AT&T is July 1, 2003. AT&T is currently in the process of determining the impact of this statement on its results of operations, financial position and cash flows. The disclosures relating to our present involvement with VIEs and our maximum exposure to losses are included in note 18.

In November 2002, the EITF reached a consensus on EITF 00-21, "Revenue Arrangements with Multiple Deliverables," related to the timing of revenue recognition for arrangements in which goods or services or both are delivered separately in a bundled sales arrangement. The EITF requires that when the deliverables included in this type of arrangement meet certain criteria they should be accounted for separately as separate units of accounting. This may result in a difference in the timing of revenue recognition but will not result in a change in the total amount of revenue recognized in a bundled sales arrangement. The allocation of revenue to the separate deliverables is based on the relative fair value of each item. If the fair value is not available for the delivered items then the residual method must be used. This method requires that the amount allocated to the undelivered items in the arrangement is their full fair value. This would result in the discount, if any, being allocated to the delivered items. This consensus is effective prospectively for arrangements entered into in fiscal periods beginning after June 15, 2003, which, for AT&T, is July 1, 2003. AT&T is currently evaluating the impact of this consensus on its results of operations, financial position and cash flows.

In January 2003, the EITF reached a consensus on EITF 02-18, "Accounting for Subsequent Investments in an Investee after Suspension of Equity Method Loss Recognition." This consensus states that if the additional investment, in whole or in part, represents the funding of prior losses, the investor should recognize previously suspended losses. This determination would be based on various factors including whether the investment results in an increased ownership percentage, the fair value of the consideration received is equivalent to the consideration paid and whether the investment is acquired from a third party or directly from an investee. If any of these provisions are met, the additional investment would generally not be considered as funding prior losses. When appropriate to recognize prior losses, the amount recognized would be limited to the amount of the additional investment determined to represent the funding of prior losses. The consensus will be effective for additional investments made after February 5, 2003.

20. Subsequent Events

In January 2003, AT&T early retired \$3.7 billion of long-term notes. In February 2003, AT&T redeemed exchangeable notes that were indexed to AT&T Wireless common stock and subsequently sold its remaining AT&T Wireless holdings. For further information on these items, see notes 7 and 8.

○ AT&T Board of Directors

David W. Dorman, 49
Chairman of the Board and Chief Executive Officer since November 2002. Elected to the Board in 2002.

Kenneth T. Derr, 66
Retired Chairman of the Board and Chief Executive Officer of Chevron Corporation, an international oil company. Director since 1995. 2, 3

M. Kathryn Eickhoff, 64
President of Eickhoff Economics, Inc., an economic consulting firm. Director since 1987. 1, 3

Frank C. Herringer, 60
Chairman of the Board and former Chief Executive Officer of Transamerica Corporation, a financial services company, which was acquired in 1999 by Aegon N.V., an international insurance organization. Elected to the Board in 2002. 1, 2

Amos B. Hostetter, Jr., 66
Chairman of Pilot House Associates, LLC, a family investment company. Director since 1999. 1, 2

Shirley Ann Jackson, Ph.D., 56
President of Rensselaer Polytechnic Institute. Elected to the Board in 2001. 2, 3

Jon C. Madonna, 59
Retired Chairman and Chief Executive Officer of KPMG, an international accounting and consulting firm. Director since 2002. 1

Donald F. McHenry, 66
Distinguished Professor in the Practice of Diplomacy at the School of Foreign Service at Georgetown University, and President of IRC Group LLC, international relations consultants. Director since 1986. 1, 3

Tony L. White, 56
Chairman of the Board, President, and Chief Executive Officer of Applera Corporation, a life sciences company. Elected to the Board in 2002. 2, 3

1. Audit Committee
2. Compensation and Employee Benefits Committee
3. Governance and Nominating Committee

Ages are as of April 17, 2003.

○ Senior Leadership Team

David W. Dorman
Chairman of the Board and
Chief Executive Officer

Mirian Graddick-Weir
Executive Vice President
Human Resources

John Polumbo
President and Chief Executive
Officer
AT&T Consumer

Betsy J. Bernard
President

Thomas W. Horton
Senior Executive Vice President,
Chief Financial Officer

Kenneth E. Sichau
President
AT&T Business Sales

James W. Cicconi
General Counsel and Executive
Vice President
Law and Government Affairs

Frank Ianna
President
AT&T Network Services

Constance K. Weaver
Executive Vice President
Public Relations, Brand &
Business Marketing

Hossein Eslambolchi
President of AT&T Labs,
Chief Technology Officer and
AT&T Business Chief
Information Officer

John C. Petrillo
Executive Vice President
Corporate Strategy and
Business Development

Other Corporate Officers

Nicholas S. Cyprus
Vice President and Controller

Robert S. Felt
Vice President, Law
and Corporate Secretary

Richard E. Sullivan, Jr.
Investor Relations Vice President

Edward M. Dwyer
Vice President and Treasurer



*David Dorman, Betsy Bernard,
Tom Horton*



*John Petrillo, Mirian Graddick-
Weir, John Polumbo*



*Jim Cicconi, Connie Weaver,
Frank Ianna*



*Hossein Eslambolchi,
Ken Sichau*

○ Corporate Information

Corporate Headquarters
One AT&T Way
Bedminster, NJ 07921-0752

Business

AT&T Business has relationships with about 4 million business customers worldwide who depend on AT&T for voice, data, Internet and managed solutions. For more information about AT&T Business and our products and services, visit our Web site at www.att.com/business. Small/medium business customers can find the right communications solution with the convenience of on-line sales and service by visiting www.att.com/businesscenter/smbushome.html. Large/ global business customers can access our expansive set of local to global business solutions by visiting www.att.com/businesscenter/lgbushome.html. Government customers can locate our suite of integrated technology solutions with professional service expertise by visiting www.att.com/gov.

Consumer

AT&T Consumer has nearly 50 million customer relationships and offers services as diverse as long distance and local services, domestic and international calling plans, prepaid and subscriber calling cards, and dial-up and broadband Internet access. AT&T Consumer also offers customers the convenience of online billing, ordering and customer service. To order a consumer service, visit our Web site at www.consumer.att.com.

AT&T on the World Wide Web

The AT&T Internet home page – www.att.com – is your entry point to a vast array of services and information. One of the most visited sites on the Internet, att.com gives you access to the latest AT&T products for your home, along with the convenience and security of online ordering and billing. The site connects business customers to the services and innovation that give their companies a competitive advantage. In addition, you can navigate to current company news, connections to investor and corporate information and the latest advances from AT&T Labs.

AT&T Giving

For more than 100 years, AT&T has built a tradition of investing in local communities through our ongoing support for education, civic and community service, the environment and the arts. In 2002, the AT&T Foundation contributed nearly \$40 million to nonprofit organizations in local communities throughout the United States and many other countries. Also in 2002, AT&T employees volunteered nearly 750,000 hours of community service through the AT&T CARES program. For more information on the AT&T Foundation and AT&T CARES, visit our Web site at www.att.com/foundation.

Environment, Health & Safety
AT&T is dedicated to creating a safe and healthy workplace for AT&T employees and strives to maintain our reputation as one of the top corporate environmental champions. More information about AT&T's environment, health and safety initiatives may be found at our Web site: www.att.com/ehs/.

TelecomPioneers

Since 1911, AT&T has been a sponsor of TelecomPioneers (formerly Telephone Pioneers of America), the world's largest, industry-based volunteer organization. AT&T employees and retirees comprise more than 57,000 of its members. In 2002, TelecomPioneers awarded the AT&T Pioneers its first President's Innovation Award. For more information on the AT&T Pioneers, visit our Web site at www.attpioneers.org.

Supplier Diversity Initiative

As part of AT&T's Supplier Diversity initiative, approximately \$870 million of AT&T's total purchases in 2002 were made from minority-, women- and service-disabled veteran-owned business enterprises. More information is available at our Web site: www.att.com/supplier_diversity/.

AT&T Communications Action Network (CAN)

On February 20, the FCC announced its Triennial Review decision, approving new rules to give states more authority over the \$125 billion U.S. local-telephone market. Jim Cicconi, AT&T Corp. General Counsel and Executive Vice President, Law and Government Affairs, said, "the result is that consumers will see lower prices and more choices in the marketplace, and the economy will experience more investment and greater innovation." To learn more about this and other important AT&T public policy issues, visit the CAN Web site at www.attcan.org. While you're there, sign up and join our Communications Action Network!

○ Shareowner Information

Shareowner Services

You can get up-to-the-minute information about your AT&T investment 24 hours a day by visiting www.att.com/ir – the AT&T Investor Relations Web site – where you will find current stock quotes, historical stock prices, financial results, tax basis information, investor news and online access to your AT&T shareowner account. Get fast information about how to arrange for the direct deposit of dividends, change your address, reinvest your dividends or transfer ownership of your shares. If you need more information, send an e-mail to att@equiserve.com, or contact us by phone at 1-800-348-8288. Our interactive voice-response system can answer most of your questions 24 hours a day, seven days a week. Representatives are available Monday through Friday, 8 a.m. to 5 p.m. (Eastern), to assist you. Shareowners outside the United States may call 1-816-843-4282. Shareowners using a telecommunications device for the deaf (TDD) may call 1-800-822-2794. Our fax number is 1-781-575-3261, and our mailing address is: AT&T Shareowner Services, c/o EquiServe, P.O. Box 43007, Providence, RI 02940-3007.

Electronic Access to Proxy Materials

In an effort to reduce the printing and mailing costs associated with the distribution of the AT&T Annual Report and Proxy Statement, AT&T registered shareowners can electronically access, view and download the AT&T Annual Report and Proxy Statement and other materials at the AT&T Investor Relations Web site at www.att.com/ir. AT&T shareowners can choose this option by marking the "Electronic Access" box on the proxy card or by following the instructions provided when voting by telephone or the Internet. If you choose this option prior to each shareowner meeting, you will receive your proxy card, which provides a notice of meeting and a business-reply envelope. Beneficial owners can request the electronic-access option by contacting their broker or financial institution.

Dividend Reinvestment Plan
Participating in the AT&T Shareowner Dividend Reinvestment and Stock Purchase Plan (DRP) is a convenient, systematic way to build your investment. Under Dividend Reinvestment, all or a portion of your dividends are automatically reinvested to purchase additional shares of AT&T common stock. Participants receive periodic account statements tracking reinvestment transactions and account balances. Additional shares of AT&T common stock can be purchased with cash or automatic monthly investments from your bank account. Fees may apply to certain transactions. To obtain a Plan prospectus, contact EquiServe at 1-800-348-8288.

Direct Registration of AT&T Shares

AT&T shareowners are finding it convenient to have shares held in the Direct Registration System, which gives you full ownership of your shares. With Direct Registration, AT&T's transfer agent (EquiServe) holds the shares in your name. You retain full ownership and continue to receive all AT&T dividends, shareowner communications, annual reports and proxy-voting material. You can easily get your account balance or sell your shares by phone or via the Internet. It's safe and convenient. For more information on this service, contact EquiServe at 1-800-348-8288.

Stock Information

AT&T (ticker symbol "T") is listed on the New York Stock Exchange, as well as the Boston, Chicago, Cincinnati, Pacific and Philadelphia exchanges in the United States; and the Euronext-Paris, and the London and Geneva stock exchanges. As of December 31, 2002, AT&T had approximately 783 million shares outstanding, held by more than 3.3 million shareowners.

Additional Financial Information

A copy of AT&T's Annual Report on Form 10-K, filed with the Securities and Exchange Commission, may be obtained free of charge by sending a request to:
One AT&T Way
Bedminster, NJ 07921
Attention: Investor Relations
or may be accessed electronically at www.att.com/ir/.

O Our Common Bond

We commit to these values to guide our decisions and behavior:

Respect for Individuals

We treat each other with respect and dignity, valuing individual and cultural differences. We communicate frequently and with candor, listening to each other regardless of level or position. Recognizing that exceptional quality begins with people, we give individuals the authority to use their capabilities to the fullest to satisfy their customers. Our environment supports personal growth and continuous learning for all AT&T people.

Dedication to Helping Customers

We truly care for each customer. We build enduring relationships by understanding and anticipating our customers' needs and by serv-

ing them better each time than the time before. AT&T customers can count on us to consistently deliver superior products and services that help them achieve their personal or business goals.

Highest Standards of Integrity

We are honest and ethical in all our business dealings, starting with how we treat each other. We keep our promises and admit our mistakes. Our personal conduct ensures that AT&T's name is always worthy of trust.

Innovation

We believe innovation is the engine that will keep us vital and growing. Our culture embraces creativity, seeks different perspectives and risks pursuing new opportunities. We create and rapidly convert technology into products and services, constantly searching for new ways to make technology more useful to customers.

Teamwork

We encourage and reward both individual and team achievements. We freely join with colleagues across organizational boundaries to advance the interests of customers and shareowners. Our team spirit extends to being responsible and caring partners in the communities where we live and work.

By living these values, AT&T aspires to set a standard of excellence worldwide that will reward our shareowners, our customers, and all AT&T people.



